



Kmart Corporation Personified

Annual reports are naturally quantitative, because numbers tell the progress of a company. Not only do the figures list physical value, but they also portray the priorities of the business.

While numbers shape a profile of Kmart Corporation, knowing some of the people behind the financial results helps bring the company into focus. All the statistics are generated, in one way or another, by people.

Nowhere is Kmart the only retailer in town—so it strives to be the best. The company believes its edge comes from a spirited, energetic force of employees working to deliver the best possible product and service to the public.

This report portrays several of the quarter-million Kmart people who helped make news in 1981. Through these few, Kmart recognizes with pride the contribution of all its employees.

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Financial Highlights

(Thousands)	1981	1980
Sales	\$16,527,012	\$14,204,381
Kmart, Kresge and Jupiter stores	2,374	2,242
Net income	\$ 220,251	\$ 260,527
Earnings per common and common equivalent share	\$1.75	\$2.07
Cash dividends declared	\$ 118,874	\$ 113,383
Per share	\$.96	\$.92
Employee compensation and benefits	\$ 2,616,776	\$ 2,267,687
Per sales dollar	15.83%	15.96%
Depreciation and amortization—owned assets	\$ 140,652	\$ 118,812
Per sales dollar	.85%	.84%
Property additions—owned assets	\$ 361,377	\$ 350,639

Corporate Profile

Kmart Corporation is the second-largest general-merchandise retailer in sales volume. The company is principally engaged in the distribution of a wide range of merchandise through the operation of a chain of discount department stores (Kmart), variety stores (Kresge) and limited-line discount stores (Jupiter). At January 27, 1982, the company operated in 2,055 Kmart units and 319 Kresge and Jupiter stores in the United States, Canada and Puerto Rico.

In addition to its wholly owned subsidiaries, which are part of the general merchandise retailing operations,

the company has an equity interest in its footwear departments in the United States, operated by the Meldisco subsidiaries of Melville Corporation, and foreign equity interests or affiliations in Australia, Mexico and Japan. The company also underwrites and markets insurance through a wholly owned subsidiary.

Additionally, Furr's Cafeterias, Inc., a wholly owned subsidiary, operates a chain of 83 cafeterias in the southwestern United States, offering high-quality food at moderate prices.

To Our Shareholders:

In 1981, Kmart Corporation total sales were \$16,527,012,000, a level comfortably above the \$16 billion sales target that was made public in 1976. The consolidated sales increase for the year was \$2,322,631,000, or 16.4% over the \$14,204,381,000 last year. Net income for the 52 weeks ended January 27, 1982 was \$220,251,000, a decrease of 15.5% from the \$260,527,000 in 1980. Earnings per common and common equivalent share were \$1.75, compared with \$2.07 last year. Fourth-quarter net income decreased 12.3% to \$114,927,000, or \$.90 per share, compared with \$131,050,000, or \$1.03 per share reported in the fourth quarter of 1980. Sales in the 1981 final quarter increased 17.5% to \$5,151,228,000.

During 1981, 171 Kmart stores opened in the United States and Canada; one Kmart store was closed. Details of the corporation's financial performance are in the financial review of this report.

Earnings in 1981 were disappointing, particularly in light of an earnings decline in 1980. We began the year anticipating the first two quarters would be difficult until our stepped-up promotional program took effect. Sales in the first quarter were up only 11.7%, while sales in the second quarter were up 16.0%. Our strategy for the year as a whole was very aggressive. Our goal—to significantly improve sales per square foot of selling space and overall market share—was largely accomplished. However, a major

premise of the plan was that our earnings potential in the third and fourth quarters would be aided by an economic environment stimulated by the 1981 business and personal tax cuts. We planned our merchandising program accordingly. The significant and rapid decline in economic activity beginning in August 1981 required adjustments to our program. Real disposable income and consumer sentiment began to deteriorate in the latter half of the year. The stage was quickly set for an industry-wide inventory reduction effort that seriously impacted our margins.

Kmart Corporation is in a state of transition. This transition, when completed, will provide your company with a strengthened competitive position to better serve the consumer of the 1980s. We are confident that our strategies to offer the consumer a broader array of the newest high-quality merchandise in a contemporary store environment will be very successful. Early results from a number of prototype programs are very encouraging. They provide convincing evidence that significantly improved sales, earnings and return on shareholders' equity will be achieved.

Our confidence in our future success also reflects an understanding of the basic resources of the corporation.

A most important Kmart resource is the depth and breadth of operating management. Kmart Corporation has developed a large pool of capable, experienced merchant-managers, exhibiting a high level of morale and integrity, intense dedication and a "can-do" attitude.

A second resource is our reputation throughout the United States as the retailer with the best prices and the best value for the dollar day in and day out. Our market research over a number of years has demonstrated a growing consumer awareness of Kmart values.

The third resource of the corporation is our unparalleled distribution of stores: 2,055 Kmart discount department stores and a total of 319 Kresge and Jupiter stores throughout the United States, Canada and Puerto Rico, serving over 80% of the buying public.

And finally, Kmart has a sound financial structure, which provides an adequate level of capital resources, even in times of depressed earnings, to continue to implement long-term plans and programs.

These resources by themselves do not assure success, but they do provide the means for extending the improved results from successful programs already implemented in only a few areas to date.

A major part of our current transition is a restructuring of our merchandising organization to delineate clearly between our hard goods and soft goods operations. This restructuring was largely completed during 1981. By the end of 1982, all apparel operations, including men's, women's, children's, infants' and fashion accessories, will be merchandised centrally under the direction of Mr. Arnold H. Bachner, chairman of Kmart Apparel Corp. This subsidiary has a successful record for using computer-based systems to control store-level departmental operations. In addition to

centralizing the merchandising programs, we intend to completely redesign and refixture the family clothing departments in all Kmart stores by year-end 1982. During 1981, a total of 628 apparel departments were provided with our new look. We have added a broader selection of nationally branded clothing to our assortments, which will enhance efforts to make Kmart even more widely known as the place to shop for quality and fashion at competitive prices.

The current restructuring on our hard goods side is two-pronged. First, the buying organization has been refined to unify merchandising for key classifications based on consumer buying patterns. Second, supporting this reorganization is a sophisticated technology-based information and control system. The catalyst for this information and control system is the complete installation of the Kmart Information Network.

Based on consumer research, we believe we have a good opportunity to sell an expanded assortment of hard goods that we previously considered beyond the price and quality range of traditional Kmart assortments. The key to this opportunity is to offer these products at low, everyday Kmart prices. Accordingly, we have expanded our merchandise in departments in which Kmart has traditionally had a dominant market share. At the same time, assortments have been edited in certain departments where our analysis indicated limited or declining opportunities for sales and profits; and throughout our assortments, we have added many more

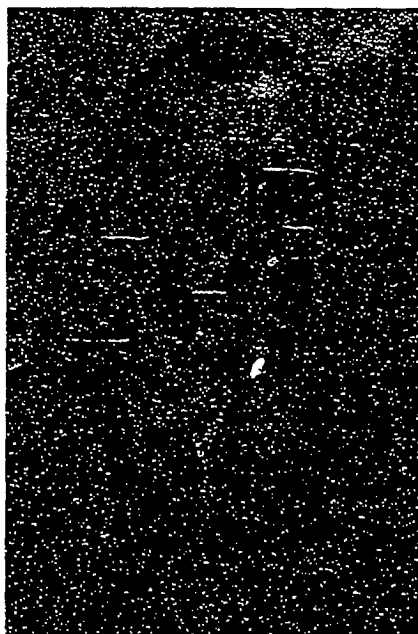
brand names to assure our continued leadership in offering national brands at competitive prices.

In September 1981, Kmart Corporation increased its growing commitment to foreign operations by entering Mexico. We acquired a 44% interest in Astra, S.A., the wholly owned retailing subsidiary of the Gentor Group of Monterrey, Mexico. Astra currently operates 16 units in the northeast quadrant of Mexico, principally in the Monterrey area. Five of the stores are similar to the European hypermarket concept, offering a full line of food and general merchandise products, and the others are self-service supermarkets. Our expansion plans include the opening of one new unit in 1982 and several more in 1983 and 1984. We believe Mexico offers an opportunity for retail growth because of the

country's rapidly expanding middle class and increasing disposable income. Through Astra, Kmart is well-positioned to capitalize on this opportunity.

Your corporation has a strong reputation for serving the consumer with exceptional values at competitive prices. We are very proud of our past success, but we recognize that in a rapidly changing consumer market, Kmart must constantly adapt and adjust to the changes demanded by the marketplace.

March 10, 1982



B. M. Fauber

B. M. Fauber
Chairman of the Board



S. G. Leftwich

S. G. Leftwich
President

Who is Kmart?

Kmart Corporation employs more than 250,000 individuals worldwide. Most work in the company's 2,374 retail units, including the 2,055 Kmart discount department stores.

But in spite of its size, Kmart is a local business to its customers. Each Kmart store is planned, placed and operated as an individual unit, with regard for the economic, environmental and social circumstances of the community.

To maintain this small-business feeling within a massive structure requires the dedication of all Kmart associates. Joining store personnel in this effort are support staff in regional offices, distribution centers, finance, data processing, merchandising, personnel, legal, real estate, construction, store operations, planning and research, government and public relations, quality control, sales promotion, advertising and transportation.

The company promotes almost entirely from within, following the 82-year precedent of founder Sebastian S. Kresge. The resulting strong morale has served Kmart well: loyalty and long service are common.

Those who succeed at Kmart are responsible and flexible—and not afraid to get their hands dirty. Kmart merchandising and operations executives begin their careers in the stockroom, learning Kmart's system by living it themselves. After 16 weeks they become assistant managers, with responsibility for several departments. As qualified, these individuals steadily receive more responsible assignments.

Kmart managers have considerable latitude to chart a course for a successful and profitable store. Through years of working with fine details in all phases of store operations, the seasoned manager becomes both a merchandiser and a manager of people.

The best Kmart managers typically become district managers for ten or twelve Kmart stores. Their wide experience then opens many paths in regional and headquarters offices.

Kmart executives have shown they can adapt: as store managers, they responded daily to multiple demands. The company trains generalists and then expects them to meet many specialized challenges.

Illustrating this versatility is the company's shift in 1962 from a chain of variety stores to a pioneer in discounting. Could a Kresge manager adjust to a far more complex store on a much larger scale? Many observers doubted it. Yet Kmart believed in its people, and the result is a thriving retail operation today.

While noting some events of 1981, the following stories also characterize the drive, dedication and flexibility of Kmart employees.

Look of '80s: a "top-down" commitment

"A night-and-day difference."

That's how some Kmart employees reacted when they saw their work place transformed—sometimes almost overnight—from early-vintage discount stores to "Kmars of the '80s."

Taking parts of an interior design prototype to be used in new Kmars, the company refurbished 463 stores in 1981. In both new and existing sites, Kmart aimed to create more pleasant and conveniently arranged stores. Most Americans shop at Kmart; the fresh look is to encourage them to think of Kmart for more of their needs.

Refurbished Kmars feature modern apparel displays and an aisle looping from the front of the midway through the clothing departments to the back of the midway. Other highlights are new wall signs and colors and six-foot-high shelves in the health and beauty aids department.

Ronald R. Dejaeghere, Kmart's director of sales promotion and advertising, is one of hundreds involved in the project. He says, "The remodeled stores give a much stronger fashion appearance. The employees live there five days a week, and for them the change is dramatic."

Much of the conversion took place after hours. "Employees would report the morning after the apparel fixtures were replaced and

Efficient use of cubic feet is an important part of the "look of the '80s." Here, sales promotion and advertising director Ronald R. Dejaeghere shows employee Linda S. Harder how to arrange "cube" displays in health and beauty aids department.



wonder how all the new merchandise had been moved into the department overnight," Dejaeghere recalls.

But in fact, no new goods had been added. Existing garments had simply been rearranged on new, smaller hanging displays—making it easier to see the "style" merchandise.

Apparel sales have been especially strong in remodeled stores, and the taller counters have prompted impulse buying with dramatic sales increases.

Appearance is not the only advantage of the new look. More hanging fixtures mean employees spend less time straightening displays, and the tall counters keep more stock available to customers.

The store remodeling program has "top-down" commitment from Kmart employees. A headquarters committee recommended the design; senior management endorsed it; Dejaeghere and other headquarters and regional personnel oversaw the work, and store staffs helped implement it.

"It's impossible to say who was responsible for what," Dejaeghere notes. Even a detail such as the design of a handbag fixture "was not one person's idea but a group effort instead."

He concludes, "This kind of project takes great loyalty. What makes Kmart people special is their ability to react to something their company is doing. The interest they take in something that's good for Kmart is incredible."

Dejaeghere, a 32-year Kmart veteran, began his career in the stockroom. He managed three Kresge stores and four Kmart's. Later he was a district manager, merchandise manager and assistant regional manager. He was corporate training director before assuming his sales promotion post in 1979. ♦

Price or prestige: customers have a choice

What's in a name? Many Kmart customers demand staple merchandise at low prices. But other shoppers prefer to buy recognized national or designer brands.

Without changing its discount-store status, Kmart continued to refine its merchandise mix, selectively adding items to broaden the appeal of assortments to satisfy all customers.

Recent new offerings include Canon 35-mm cameras, Memorex tapes, ceiling fans, kerosene heaters, Rustoleum spray paints, Smith-Corona typewriters and percale sheet sets in fashion colors and styles.

Some notable additions in 1981 were in the apparel departments, where customers found a new array of discounted fashion garments along with value-priced basic clothing.

Results were marked: Kmart's women's and girls' clothing subsidiary posted a 17.6% sales gain for fiscal 1981.

Bridget M. Jones, an apparel district manager, says response to the fashion goods has been overwhelming.

"One customer said she had seen a particular pair of slacks at a local department store, and the price was higher than Kmart's," relates Jones. "She said the material and styling were the same. That's good to hear."

Employees, too, are impressed with the changes, according to Jones. "I believe enthusiasm is on the increase because our people take great pride in the merchandise: they know it well and are able to talk with the customer about it."



Specifications supervisor Peggy Cartwright checks dimensions and construction of men's slacks.

Future merchandise introductions include Jonathan Logan sportswear, which will go to selected stores in major markets for the coming back-to-school season.

Kmart recently streamlined its merchandise district manager program, giving one individual responsibility for men's and women's apparel. Jones says the change makes sense: "The management and merchandise training I have developed through ladies' apparel can be applied directly to menswear."

But Kmart has not forsaken the value-conscious customer, either. One who knows is Peggy Cartwright, supervisor of wearing apparel specifications for Kmart private-label merchandise, who monitors workmanship, sizing and construction of garments. (Other quality control employees perform some 30 apparel tests, such as thread count, yarn number, fiber content, washability and color fastness.)

Plants that sew Kmart private-label goods often produce clothing for national manufacturers and nondiscount retailers as well, Cartwright points out. And some items—Challenger jeans, for example—are made from materials from firms that also supply fabric for comparable national-brand goods.

Recently, Cartwright compared one maker's infants' snowsuits sold both by Kmart and by another national retailer. Her report showed the only difference between the two garments was method of sizing: Kmart's three sizes were based on age, while height and weight determined the other merchant's two sizes. Yet the item retailed for \$4.02 more at the other store than at Kmart.

"That tells me we really have a fantastic item in the store," Cartwright says, "and there's just no difference between the two."

Much of Cartwright's work takes place before garments are made and in plant inspections during production.

"We took men's outerwear samples and tore them apart inside out," she notes. "We recommended different seam construction and finished garment dimensions. We also did guidelines for outerwear fabrication that the buyer took to manufacturers."

Quality has been enhanced in garments that have undergone specification studies. Team efforts among buyers, manufacturers and Cartwright's office have brought a greater selection of excellent garments into the stores.

Throughout Kmart, people like Jones and Cartwright are helping to provide what the customer wants—label or no label.

Jones entered the Kmart Apparel Corp. training program in 1976. She progressed to assistant manager, headed apparel departments in three stores and became district manager. Her territory includes 12 stores in Michigan. She has a B.S. in social science.

Cartwright managed a women's specialty shop before joining Kmart headquarters 15 years ago. She performed softline tests in the quality control department before assuming her current post, a new one for Kmart, two years ago. ♦

Apparel district manager Bridget M. Jones (left) and store apparel manager Cathy M. Cole are proud to offer Jonathan Logan sportswear beginning this summer.



The basics: making complex Kmarts manageable

In 1979, Robert A. Miller got his first Kmart store management assignment. But it was hardly a glamour job; Miller was to run an Atlanta Kmart troubled with merchandising and personnel problems.

His exemplary performance there was quickly recognized, and in mid-1981 Miller was promoted to manage another Atlanta Kmart. In rapid succession he faced a two-month refurbishing, competition from a new Kmart, the Christmas rush, January white sale, Dollar Days and inventory.

Though the pace has been frantic, Miller is buoyed by the best yearly sales and profits ever in his current store.

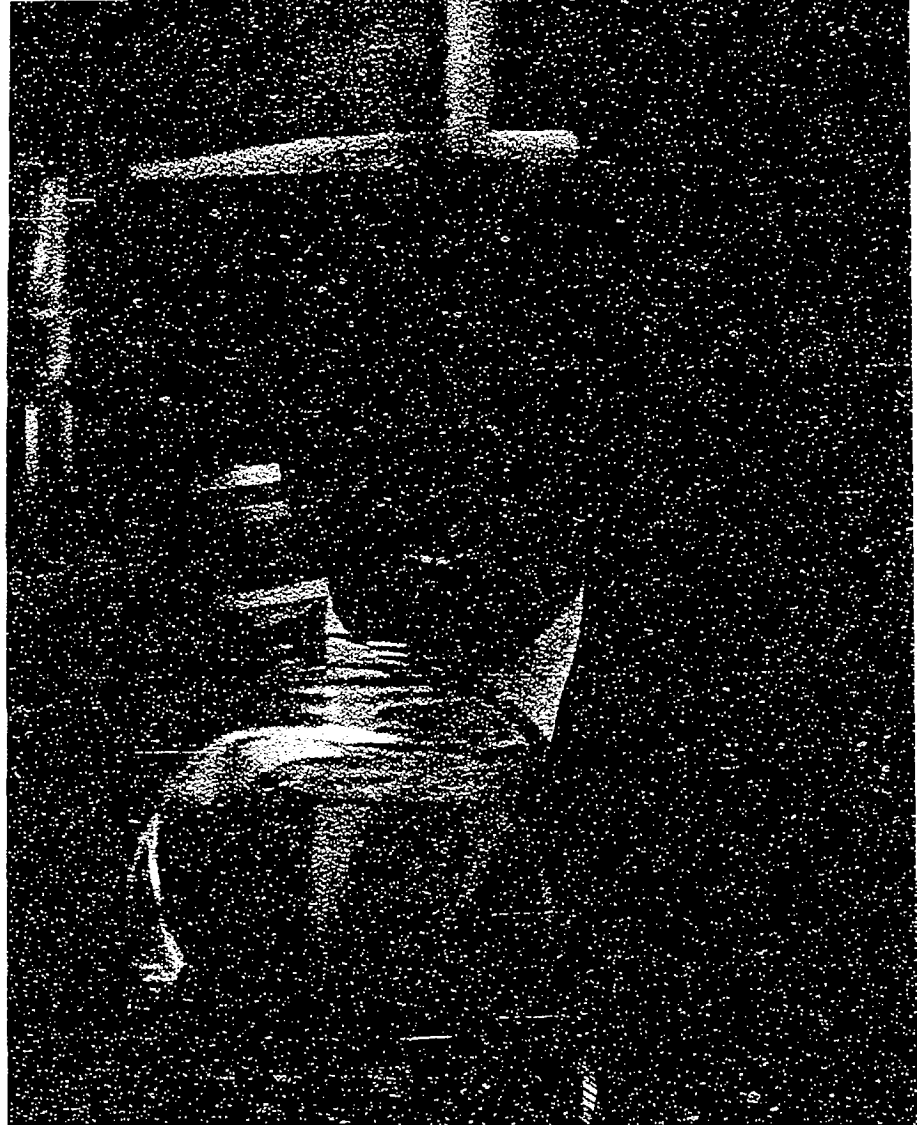
He credits his achievements to "following the basics"—knowing the merchandise, the market and the people.

"The same things that were taught to us as young assistants ten years ago still work today," he claims. "The key is to be consistent and maintain strong basic assortments."

Another remnant from his trainee days is Miller's participatory style. He is usually on the selling floor or in the stockroom, rarely at his desk. He expects—and gets—hard work from his employees, but he rolls up his sleeves and pitches in when the occasion warrants.

Dollar Days started three days early this year, on the heels of a record two-day Christmas sales finale, a brisk white sale and two short work weeks.

"The manager and assistants were all out there moving freight," Miller says. But the payoff was big: sales were up 73% over the same



Manager Robert A. Miller credits employee Sharon E. Mitchell for a successful pet department: "She has the touch and is a caring individual."

week in 1981, making it the store's best Dollar Days ever.

Last summer's remodeling also demanded long hours, vigilant supervision and hard work from Miller. Yet the transformation "had to be a highlight of my life," he maintains. He is especially proud of the cleanliness the updated design prompted—down to spotless staff lounges and shining thresholds.

Regard for his 128 employees has much to do with his success, say regional executives. "Sure, I know them all by name," the manager says of his staff.

Miller notes his technique is to "work with them, not on them."

But he does point out mistakes, then expects they won't happen again.

"Wet pets," dismissed in many stores as a bother, sell well here. Miller says many of his customers are apartment-dwellers with limited space, and some local competitors have quit selling fish because they are hard to care for.

But fish are a successful product in Miller's Kmart mainly because the pet clerk "has the touch and is a caring individual."

In fact, he says, "all of our excellent departments have above-average employees. They care, and it shows."

Just as Miller refuses to throw

out "wet pets" only because others did, he is also quick to act on an ill-performing department. In his first store, he boosted profits partly by dropping fish, closing the patio department and streamlining toys and appliances.

In both stores, he has tailored goods to customers' demands, focusing on middle-priced basics. For instance, he stocks many 24" open-top grills but few gas models. Most of the vitamin shelves display staples, such as vitamins A, C and E.

He knows the stock thoroughly in this full-size Kmart; he can discuss panty hose as easily as cabinet hardware.

During his rounds, Miller often stops to ask a puzzled-looking customer how he can help. "Do you sell travel irons?" a woman asks. He leads her to a display, citing features and prices. Then he suggests a portable ironing board, too.

Those he works for say it is this regard for people, mind for detail, flexibility and resourcefulness that explain Miller's success.

Miller began as a Kmart stock clerk in South Carolina in 1968. He was assistant manager in four stores before his promotion to merchandise manager in 1976. He was named store manager in 1979 and reassigned in 1981. He holds a B.S. in business. ♦

TRIM: *balancing supply and demand*

Have what the customer wants, but no more. Successful retailers live by those words.

One plan designed to strengthen that goal is Kmart's Total Retail Inventory Management program, popularly called TRIM within the company. A TRIM committee of Kmart executives explores ways to keep Kmart's merchandise investment at optimum levels for highest sales, profit and turnover.

Rebecca J. Blackwell and Gary N. Sweetapple are among hundreds of Kmart employees who work directly with systems to streamline inventories and promote productivity.

As manager of centralized merchandise systems, Sweetapple is developing procedures for more accurate control of inventories and distribution of merchandise. In 13 years, he has served in most every operating and support area of Kmart.

Blackwell is assistant to the executive vice president of merchandising. She works with several electronic devices that promise to improve efficiency.

With one such program, store employees use a wand to scan hardline merchandise on the sales floor and in the stockroom, assuring accurate replacement of goods. An employee simply scans a bar code label on displays that hold less than desired quantities. Later the scanner device is connected to an electronic unit that relays orders to Kmart headquarters.

Wand-ordering is simpler and quicker than the operation it replaces, in which data was recorded by hand into list books. By late 1982, all Kmarts will have scanners, allowing one person to order for a department in less than half the previous time.

The scanners are an extension of the Merchandise Ordering Processing System (MOPS), based on a numbering scheme that categorizes stock and will eventually provide for automated list books. Orders move

TRIM specialists Gary N. Sweetapple and Rebecca J. Blackwell say the wand ordering system is a time-saver. Housewares employee Carol A. Hooch, who uses the system, agrees.



electronically to headquarters, creating a history for buyers, who can then edit the orders and relay them to a vendor or distribution center. (Many suppliers are even equipped to receive orders electronically rather than by mail.)

With MOPS, buyers can project more accurately what and how much will be needed for each season in different geographical areas.

And, Sweetapple notes, buyers can negotiate with vendors based on current information. Because they know when a regular source can't handle an order, buyers can divert it elsewhere without delay.



The scanning operation is accurate and easy to use.

Blackwell adds, "MOPS gives buyers a chance to review orders and correct them immediately. If something's wrong, they can stop it now. The system also eliminates paperwork, mailing time and postage."

Kmart Information Network (KIN) is an electronic system that supports inventory management programs and streamlines office procedures. KIN simplifies cash and sales reporting, payroll preparation and invoicing. It also sends messages between headquarters and stores.

By late 1982, all U.S. Kmart's will use KIN; two-thirds of the stores were on-line at the end of 1981.

Blackwell, who wrote and refined KIN procedures for three years, says "The calculating and reporting of all figures in the stores is much easier, faster and more accurate with KIN. We even use KIN to record inventory figures!"

She adds that KIN will continue to be vital in expanding automated systems linking headquarters, the stores and distribution centers.

Sweetapple's current priority is to establish central merchandising systems for men's, infants', fashion accessories and sporting goods departments. Aided by procedures like those of Kmart Apparel for women's clothing, buyers at headquarters will control quantities and timing of orders.

Hundreds work directly with inventory management recommendations, and thousands implement TRIM in the stores. As Sweetapple observes, "Virtually everyone in the company is affected by TRIM." For top efficiency, he maintains, there must be effective communication among all areas in the company.

"The ultimate objective of TRIM makes the acronym an understatement," Sweetapple says. Originally charged with finding ways to manage inventories better, the committee "soon realized we couldn't do that without addressing the whole operation."

"TRIM has become an all-encompassing program to come up with the most effective way for Kmart to organize all (corporate merchandising) activities," he adds.

Coincidentally, Sweetapple was assistant manager at what would be the first Kmart to test the scanner system. Such procedures "were not even dreamed of when I left the store in 1972," he recalls. "Now we're jumping into the best available technology to assist in our merchandising."

Blackwell joined Kmart in 1968 through a store in Des Plaines, Ill. Five years in the stores and two years of college led to a six-year road tour as office training supervisor for new stores. She was a KIN specialist at headquarters before her current position, which began in January 1982.

Sweetapple was hired in 1969 as a Kresge stockperson. After receiving a B.A. degree, he became a Kmart assistant manager. He later served in Kmart's financial reporting department, at Ft. Wayne Distribution Center as senior accountant and on various developmental projects, and as an associate buyer. He earned a master's in business while working full-time. ♦

K Care: training strengthens auto service

Merchandise isn't everything in Kmart stores. A substantial part of Kmart's "assortment" now relates to services rather than goods. And delivering those services well requires informed, trained and courteous individuals.

In 1981, Kmart's automotive division launched the K Care program, which emphasizes high-quality automotive service from qualified professionals. K Care is supported with multi-media advertising.

K Care training for auto mechanics illustrates Kmart's commitment to the best service. At five training centers across the country, auto service employees attend three separate five-day courses: alignment/suspension, brakes and tuneup/electrical. To complete the program successfully, mechanics must meet strict standards.

Some 140 mechanics are enrolled weekly in the courses, where students work with equipment and parts used on the job. Classroom lessons and

homework are also part of the regimen. At year-end, Kmart had awarded some 5,000 certificates of accomplishment.

Kenneth E. Ryland, national automotive service manager, believes the company is seeing rewards from the program. "We've received many compliments. Customers have remarked on the attitude and ability of our personnel," he says. "Our people are demonstrating pride and professionalism."

Ryland calls K Care training a morale-builder. "We've noticed a great difference: students learn to believe in themselves and gain

confidence that they can do the job properly and quickly."

Lower employee turnover has resulted from K Care training. "We're building a much more loyal group," Ryland notes. "They realize they can have a future with Kmart, so they're willing to put forth more effort simply because we have shown interest in teaching them."

David T. Henderson, service manager in training, concurs. He is only 20 and has just three years' experience at Kmart, but he intends to "move up as fast and as high as I can." The first step in his climb was as a night tire-changer.

Henderson credits both himself and Kmart for his rapid progress.

"Kmart was interested enough in me to send me to school. That was a plus, but so was my desire to learn."

"My manager has pushed me up," he continues, "but I've also made him look good with my ability to do the work—so it goes both ways."

Henderson cites discount prices and quick, efficient work as basic to Kmart's automotive service. His most ringing endorsement, though, is his personal confidence in Kmart: "Even if I didn't work here, I'd still take my car here!"

Service is a complex business. In Ryland's words, "You can't see, hold or feel service—it's not like buying a new jacket. It's a commodity a person needs rather than wants."

Programs such as K Care represent Kmart's resolve to serve customers efficiently, correctly and economically.

Ryland joined the company in 1969 as a Kmart automotive service manager. He became a district manager in 1971. Later, he was assistant auto service manager for the Central Region and then was named regional manager of the Eastern Region automotive division. He has held his current post since 1980.

Henderson was an 11th-grade cooperative education student when he started in a Kmart stockroom in 1978. In three months, he was promoted to night tire-changer, and after a year he progressed to night service writer. Now a high school graduate, he became service manager in training last year. ♦

K Care mechanic Robert A. Wachtmeister (left) and service manager in training David T. Henderson check engine timing. Kenneth E. Ryland, national automotive service manager, observes from foreground.



10-Year Financial Summary

		1981	1980
SUMMARY OF OPERATIONS (Millions)	Sales	\$16,527	\$14,204
	Licensee fees and other income	196	175
	Cost of merchandise sold	12,360	10,417
	Selling, general and administrative expenses	3,810	3,326
	Interest expense—net		
	Debt	69	65
	Capital leases	161	135
	Income before estimated income taxes	\$ 323	\$ 436
	Income from retail operations	\$ 216	\$ 256
	Net income	\$ 220	\$ 261
PER SHARE DATA (Dollars)	Earnings per common and common equivalent share	\$ 1.75	\$ 2.07
	Cash dividends declared	\$.96	\$.92
	Book value	\$ 19.81	\$ 18.99
FINANCIAL DATA (Millions)	Working capital	\$ 1,430	\$ 1,526
	Total assets	\$ 6,673	\$ 6,102
	Long-term obligations		
	Debt	\$ 415	\$ 419
	Capital leases	\$ 1,752	\$ 1,618
	Average shares outstanding	124	123
FINANCIAL RATIOS	Return on sales		
	Income before estimated income taxes	2.0%	3.1%
	Income from retail operations	1.3%	1.8%
	Net income	1.3%	1.8%
	Return on assets (beginning)	3.6%	4.6%
	Debt and equivalent as a % of total capitalization	46.9%	46.7%
	Return on stockholders' equity (beginning)	9.4%	11.9%
	Employee compensation and benefits, per sales dollar	15.8%	16.0%
	Current ratio	1.7	1.9

Data reflects the adoption of LIFO in 1974 and all poolings-of-interests.

1979	1978	1977	1976	1975	1974	1973	1972
\$12,731	\$11,696	\$9,941	\$8,382	\$6,798	\$5,536	\$4,633	\$3,837
165	139	123	102	86	76	69	65
9,283	8,566	7,299	6,147	4,991	4,197	3,462	2,868
2,839	2,503	2,085	1,750	1,409	1,147	931	785
29	17	12	8	12	21	13	8
120	115	104	95	77	63	50	38
\$ 625	\$ 634	\$ 564	\$ 484	\$ 395	\$ 184	\$ 246	\$ 203
\$ 355	\$ 342	\$ 296	\$ 261	\$ 204	\$ 99	\$ 131	\$ 112
\$ 358	\$ 344	\$ 298	\$ 262	\$ 196	\$ 102	\$ 133	\$ 114
\$ 2.84	\$ 2.74	\$ 2.39	\$ 2.11	\$ 1.61	\$.85	\$ 1.11	\$.97
\$.84	\$.72	\$.56	\$.32	\$.24	\$.22	\$.20	\$.173
\$ 17.79	\$ 15.68	\$13.56	\$11.62	\$ 9.69	\$ 8.25	\$ 7.55	\$ 6.57
\$ 1,388	\$ 1,308	\$1,231	\$1,074	\$ 904	\$ 773	\$ 574	\$ 457
\$ 5,642	\$ 4,836	\$4,489	\$3,983	\$3,336	\$2,719	\$2,344	\$1,968
\$ 209	\$ 209	\$ 211	\$ 211	\$ 210	\$ 212	\$ 21	\$ 23
\$ 1,422	\$ 1,294	\$1,266	\$1,155	\$ 989	\$ 846	\$ 712	\$ 568
123	122	122	121	121	120	120	113
4.9%	5.4%	5.7%	5.8%	5.8%	3.3%	5.3%	5.3%
2.8%	2.9%	3.0%	3.1%	3.0%	1.8%	2.8%	2.9%
2.8%	2.9%	3.0%	3.1%	2.9%	1.8%	2.9%	3.0%
7.4%	7.7%	7.5%	7.8%	7.2%	4.3%	6.7%	7.4%
43.1%	44.4%	47.7%	49.6%	51.0%	51.9%	45.3%	43.6%
18.7%	20.8%	21.1%	22.4%	19.8%	11.3%	16.9%	20.7%
15.2%	14.6%	14.3%	14.3%	14.3%	14.5%	14.4%	14.6%
1.8	1.9	1.9	1.9	2.0	2.2	1.8	1.8

1981 Operations and Financial Review

Corporate Goals

The decade of the 1980s has begun in a very difficult economic environment, which has included high rates of inflation, interest and unemployment, causing a significant decline in consumer confidence.

Such conditions also have contributed to Kmart Corporation's weaker earnings performance over the past two years, temporarily interrupting the company's many years of rapid and consistent growth.

The current retail environment is very competitive and challenging, causing many companies, including Kmart Corporation, to examine their strategies more closely.

To meet the many challenges of the 1980s, the company has changed the emphasis in its corporate and merchandising goals as follows:

- To devote more management and financial resources to existing facilities rather than continued maximum expansion of new retail units.
- To capitalize on the leverage potential inherent in incremental sales increases and increased efficiencies in the existing store base.
- To aggressively seek diversification opportunities.

As the Kmart store program begins its third decade, the company is concentrating more resources on refurbishing existing store facilities. The refurbishment program involves new interior decor, more efficient and attractive fixtures and displays and more convenient departmental adjacencies. All stores opened in 1981 have adopted the new format, and an additional 463 stores were refurbished in varying degrees during the year.

Also, the company is restructuring both the hard and soft goods merchandising operations. By the end of 1982, women's ready-to-wear, men's and boys' wear, infants' wear and fashion accessories will be primarily merchandised on a centralized system. This operation will be directed by Kmart Apparel Corp., the company's wholly owned women's ready-to-wear subsidiary, which has had proven success in using computer-based technologies to assist in the control of store-level merchandising.

At the same time, the company is refining the responsibility for key merchandising classifications within the hard goods department on the basis of consumer buying patterns.

Effective September 4, 1981, Kmart Corporation acquired 44% of Astra, S.A. ("Astra"), which was previously a wholly owned retailing subsidiary of the Gentor Group of Monterrey, Mexico. Astra is a holding company with food, general merchandise and related real estate operations in

Mexico. The food and general merchandise subsidiaries operate five "Astra" discount-type stores and eleven self-service-food-type "Autodescuento" stores in the cities of Monterrey and Saltillo in northeast Mexico, and in the cities of Reynosa, Matamoros and Nuevo Laredo along the Mexican-United States border. This acquisition offers an opportunity for rapid expansion of retailing operations to serve a growing Mexican population that is gaining in buying power.

The company's initial investment of \$50.0 million in Astra has been accounted for using the equity method. Operating results since the date of acquisition are included in income. Further information on the acquisition is summarized in Note (B) of the accompanying Notes to Consolidated Financial Statements.

New Store Openings

During 1981, the company opened 165 Kmart stores in the United States and six in Canada. Kmart has continually expanded into key markets with high potential to significantly improve the company's share of mass merchandising sales. The company is represented in 48 of the 50 states and in 306 of the country's 318 Standard Metropolitan Statistical Areas (SMSAs) as well as in two of the five SMSAs in Puerto Rico. The company is represented in all provinces in Canada.

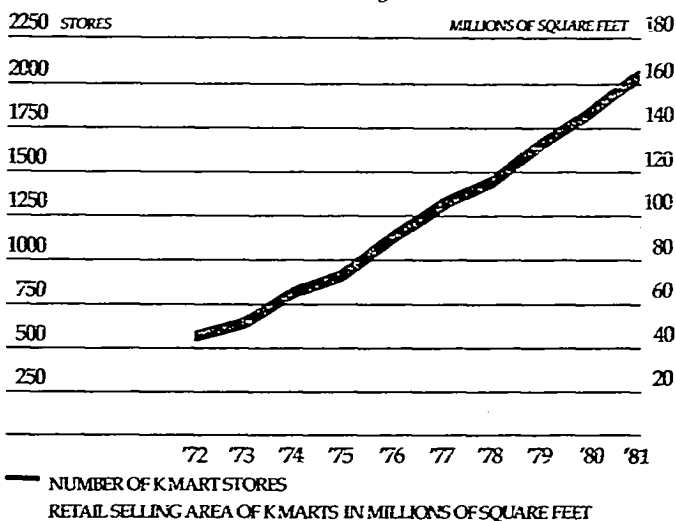
In 1981, Kmart stores generated more than 96% of the company's business. Kmart stores generally range in size from 40,000 to 120,000 square feet. Standard-size stores are 68,000 to 84,000 square feet, medium-size stores are 55,000 to 60,000 square feet and the small stores are approximately 40,000 square feet.

As in prior years, the company continued to close stores that did not operate at acceptable profit levels.

The 1981 expansion program is summarized as follows:

General Merchandise Stores	In Operation Jan. 28, 1981	Units Opened	Units Closed	In Operation Jan. 27, 1982
Kmart Stores				
U.S.	1,775	165	(1)	1,939
Canada	110	6		116
Total Kmart Stores	1,885	171	(1)	2,055
Kresge and Jupiter Stores				
U.S.	287		(35)	252
Canada	70		(3)	67
Total Kresge and Jupiter Stores	357		(38)	319
Total General Merchandise Stores	2,242	171	(39)	2,374
Additional Retail Units				
Furr's Cafeterias	76	7		83
Canadian Shoe Retail	85	17	(4)	98

NUMBER OF KMART STORES AND RETAIL SELLING AREA (Excluding Australian Stores)



Kmart store selling area increased 8.3% in 1981 to 119.5 million square feet. In the past ten years, Kmart square feet of selling area has increased at a compound annual rate of 14.5%.

Sales and Store Statistics	1981	1980	1979	1978	1977
<i>(Millions U.S. \$)</i>					
Sales Analysis					
Kmart	\$15,903	\$13,617	\$12,249	\$11,208	\$ 9,447
Other	624	587	482	488	494
Total Sales	\$16,527	\$14,204	\$12,731	\$11,696	\$ 9,941
U.S.					
Canada	\$15,752	\$13,468	\$12,077	\$10,682	\$ 9,064
Australia*	775	736	654	605	572
Total Sales	\$16,527	\$14,204	\$12,731	\$11,696	\$ 9,941
General Merchandise Stores					
Kmart Stores					
U.S.	1,939	1,775	1,584	1,397	1,243
Canada	116	110	104	99	91
Australia*					33
Total Kmart Stores	2,055	1,885	1,688	1,496	1,367
Kresge and Jupiter Stores					
U.S.	252	287	310	321	339
Canada	67	70	71	74	76
Total Kresge and Jupiter Stores	319	357	381	395	415
Total General Merchandise Stores	2,374	2,242	2,069	1,891	1,782
Additional Retail Units					
Furr's Cafeterias	83	76			
Canadian Shoe Retail	98	85	77		
<i>(Millions of square feet)</i>					
General Merchandise Retail Selling Area					
Kmart	119.5	110.3	99.1	89.6	82.8
Kresge and Jupiter	4.1	4.7	4.9	5.1	5.3
Total Retail Selling Area	123.6	115.0	104.0	94.7	88.1
Kmart Sales Per Square Foot**	\$146	\$139	\$138	\$135	\$127

*Since sale of the company's majority interest in Kmart (Australia) Limited in December 1978 for 20% of G. J. Coles & Coy. Limited, operations are no longer consolidated.

**Sales per square foot were calculated as follows: Total Kmart sales plus unconsolidated sales of Kmart licensees divided by total Kmart store retail selling area for all Kmart stores open for one full year as of the end of each fiscal year. (Excludes Australian stores.)

Management's Discussion and Analysis of Operations and Financial Condition

Results of Operations

Sales—K mart Corporation's unbroken trend of sales increases continued in 1981. Consolidated sales reached \$16.5 billion, an increase of 16.4% over 1980.

A three-year summary of the company's domestic and Canadian sales follows:

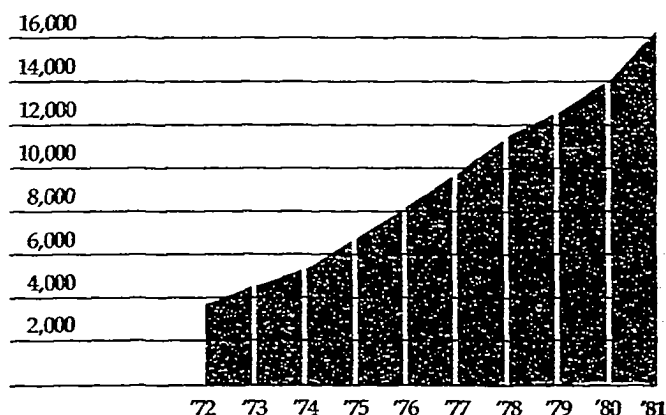
(Millions U.S. \$)	1981	% Increase	1980	% Increase	1979
Domestic	\$15,752.3	17.0	\$13,467.7	11.5	\$12,077.5
Canadian	774.7	5.2	736.7	12.7	653.6
Total	<u>\$16,527.0</u>	16.4	<u>\$14,204.4</u>	11.6	<u>\$12,731.1</u>

The growth in 1981 sales came primarily from the opening of 171 new K mart stores, aggressive promotional programs and inflation. Sales for comparable stores for the year increased 10.4%. Despite the difficult economic climate and intense competition among retailers, fiscal 1981 sales were slightly above expectations.

Sales rose 11.6% in 1980 to \$14.2 billion. This increase was primarily attributable to 199 new K mart store openings, inflation, the acquisition of Furr's Cafeterias, Inc., and the inclusion of a full year's sales in 1980 of the Canadian footwear operations acquired on November 18, 1979. Year-to-year sales gains for comparable stores were 3.8%. Fiscal 1980 sales were slightly below expectations, reflecting the economic weakness prevailing throughout the United States and Canada.

SALES

\$18,000 (Millions)



Income—Income before estimated income taxes in 1981 was \$322.9 million, a decrease of 26.0% from 1980. Income before estimated income taxes in 1980 was \$436.4 million, a decrease of 30.1% from 1979.

The effective income tax rate in 1981 was 33.2% compared with 41.4% in 1980 and 43.2% in 1979. The decrease in both 1981 and 1980 was due primarily to increased tax credits and to the relatively larger equity earnings of the footwear department and the Australian investment in G. J. Coles & Coy. Limited, compared with earnings from operations, which are subject to normal income tax rates. Additional information is summarized in Note (F) of the accompanying Notes to Consolidated Financial Statements.

The company's domestic and foreign net income is summarized as follows:

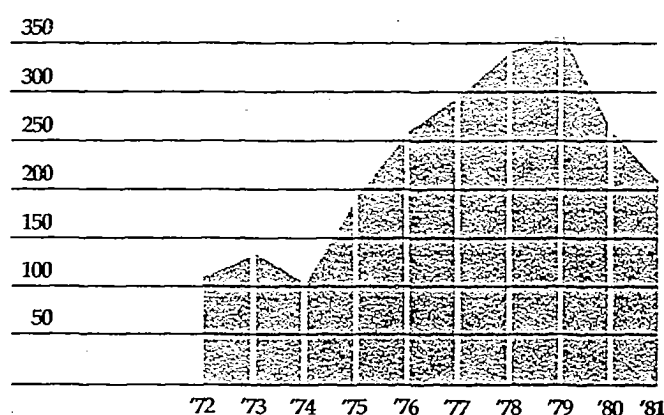
(Millions U.S. \$)	1981	% Increase (Decrease)	1980	% (Decrease)	1979
Domestic	\$195.6	(17.4)	\$236.9	(28.9)	\$333.1
Foreign	24.7	4.3	23.6	(5.4)	24.9
Total	<u>\$220.3</u>	(15.5)	<u>\$260.5</u>	(27.2)	<u>\$358.0</u>
Earnings per common and common equiv- alent share	<u>\$ 1.75</u>	(15.5)	<u>\$ 2.07</u>	(27.1)	<u>\$ 2.84</u>

Major factors contributing to net income results were:

Cost of Merchandise Sold—Cost of merchandise sold (including buying and occupancy costs) in 1981 was 74.8% of sales compared with 73.3% in 1980. During 1981, K mart planned and implemented aggressive promotional programs and competitive pricing policies that resulted in increased market share. However, these strategies caused 1981 gross margins to decline to 25.2% of sales compared

NET INCOME

\$400 (Millions)



with 26.7% for 1980. Weakness in the general economy contributed to the decline in gross margins, as consumers became more value-conscious and spent less freely.

In addition, the company reports inventory on the last-in, first-out ("LIFO") basis for substantially all domestic inventories as opposed to the first-in, first-out ("FIFO") basis. The company believes the LIFO method more accurately matches current costs with current revenues and measures the impact of inflation on inventories during periods of rising prices. Based on the U.S. Department of Labor's Department Store Inventory Price Index for the year ended January 1982, the inflationary impact on inventories was \$139.4 million in 1981 compared with \$112.6 million in 1980.

Cost of merchandise sold (including buying and occupancy costs) as a percentage of sales was 73.3% in 1980 compared with 72.9% in 1979, resulting in gross margin rates of 26.7% and 27.1%, respectively. The decline in the gross margin rate was primarily attributable to a sharp rise in the annual LIFO adjustment reflecting the country's higher inflationary environment and also weak consumer demand resulting from depressed economic conditions during virtually all of fiscal 1980. The inflationary impact on inventories was \$112.6 million in 1980 compared with \$72.2 million in 1979. The decline in the gross margin was slightly offset by the higher gross margin achieved by the newly acquired cafeteria subsidiary.

Operating Expenses—Selling, general and administrative ("SGA") expenses, including advertising, were 23.1% of sales in 1981 compared with 23.4% for 1980 and 22.3% for 1979. Continued strength in sales volume during 1981 combined with improved productivity and expense control provided the improvement in the SGA expense ratio for 1981. Also, increased productivity has been realized through the use of in-store computers that connect K mart International Headquarters to its stores, distribution centers, subsidiaries and selected suppliers. The company had installed 1,386 store computers by the end of fiscal 1981; 627 in 1981 alone. By the end of fiscal 1982, all U.S. K mart stores will be included in the network.

Increases in operating expenses for 1981 and 1980 were primarily attributable to the following:

Employee compensation and benefits increased 15.4% to \$2.6 billion in 1981 and 16.9% to \$2.3 billion in 1980. The increase in both years resulted primarily from the "ripple effect" of minimum wage increases and employee benefit programs. The rising cost of health care programs was a factor, increasing 30.0% and 46.1% in 1981 and 1980, respectively. Total pension expense was \$40.8 million for 1981 and \$37.9 million for 1980.

Payroll, property and franchise taxes increased 18.5% to \$305.9 million in 1981 and 13.5% to \$258.2 million in 1980. These increases were due to the store expansion program, increases in payroll taxes and other tax increases on existing stores.

Depreciation and amortization expense for owned property increased 18.4% to \$140.7 million in 1981 and 27.3% to \$118.8 million in 1980, compared with respective prior years. These increases resulted from opening a large number of new stores, refurbishing programs and continued high inflation of construction and fixture costs.

Net Interest Expense on Debt—Net interest expense related to debt increased 5.8% to \$69.2 million in 1981 and 123.6% to \$65.4 million in 1980. The increase in both years was due to the unparalleled high level of short-term interest rates and increased borrowings. The weighted average interest rates for short-term borrowings were 15.7%, 12.5% and 11.4% for 1981, 1980 and 1979, respectively. In both 1981 and 1980, borrowings increased because of the company's store expansion and modernization programs. Additional borrowings were needed in 1981 due to increased levels of inventory needed to maintain the high level of sales activity and the acquisition of the 44% equity interest in Astra, S.A. In 1980, borrowings rose due to increased levels of inventory during the year and the acquisition of Furr's Cafeterias, Inc.

Foreign Operations—K mart Canada Limited's sales for 1981 in Canadian dollars increased 7.5% as compared with 12.9% in 1980. Net income for both 1981 and 1980 was below the respective prior years primarily due to high inflation, unemployment, and competitive pressures. Gross profit margins in 1981 were below 1980 primarily due to heavy promotional activity. Operating expenses in Canadian dollars increased 14.2% in 1981. Employee compensation and benefits were a major factor contributing to the increase in operating expenses.

The company's income from Australian operations, which consisted primarily of equity income in G. J. Coles & Coy. Limited ("Coles"), increased to \$20.1 million in 1981 compared with \$11.5 million in 1980. In 1979, the company's income from Australian operations was \$12.5 million. The increase in 1981 income was primarily attributable to a currency fluctuation gain of \$2.7 million included in equity income, compared with a \$3.0 million loss in 1980.

As of July 26, 1981, Coles' fiscal year-end, sales reached \$3.2 billion in Australian dollars, an increase of 21.7% over fiscal 1980. Sales for fiscal 1980 were \$2.7 billion in Australian dollars, an increase of 20.4% over fiscal 1979. Pre-tax profit from operations increased 21.1% to \$117.5 million in 1981 and 16.9% to \$97.1 million in 1980 compared

with respective prior years. The Coles results for 1979 incorporate the operations of K mart (Australia) Limited and comparative 52-week fiscal years on a pro-forma basis. For fiscal 1981, 12 additional K marts and 21 new supermarkets were opened. As of July 26, 1981, the total number of stores operated by Coles in Australia was 68 K marts, 362 supermarkets and food markets and 170 variety and other stores. Additional information on the company's investment in Coles appears in Note (D) of the accompanying Notes to Consolidated Financial Statements.

In September 1981, the company acquired for \$50.0 million, 44% of Astra, S.A. ("Astra"), which was previously a wholly owned retailing subsidiary of the Gentor Group of Monterrey, Mexico. K mart will have a significant role in developing Astra's general merchandise operations in Mexico. The stores will employ substantially the same "K mart" general merchandising system that has been developed and applied in the United States, Canada, Puerto Rico and Australia. The company's equity share of Astra's results for four months ended December 31, 1981 showed a minor loss due primarily to expansion of Astra's headquarters staff and interest expense caused by Astra's preparation for its planned store opening program. Refer to Note (B) of the accompanying Notes to Consolidated Financial Statements for further information on the acquisition.

Licensee Operations—The company's footwear departments in the United States are operated by the Meldisco subsidiaries of Melville Corporation. At January 27, 1982, there were 1,939 U.S. footwear departments in operation. Sales of the licensee footwear departments rose 9.4% to \$688.6 million and 9.9% to \$629.2 million in 1980, compared with the respective prior years. Equity in income increased 4.8% to \$27.7 million in 1981 and 7.7% to \$26.5 million in 1980 compared with the respective prior years. Further information on the company's investment in Meldisco is summarized in Note (D) of the accompanying Notes to Consolidated Financial Statements.

Additionally, the company receives fee income under a license agreement established in 1980 with The Daiei, Inc. ("Daiei"), the largest retailer in Japan. K mart is currently providing Daiei with knowledge and assistance to develop mass merchandising operations in Japan and is also granting exclusive rights to Daiei to use various K mart tradenames and trademarks.

Furr's Cafeterias, Inc.—Furr's Cafeterias, Inc. ("Furr's"), which was acquired by K mart through a wholly owned subsidiary, operates a chain of cafeterias in the southwestern United States. As of January 27, 1982, there were 83 cafeterias in operation. Furr's sales increased 18.5% in 1981 compared with 15.6% in 1980.

Insurance Operations—Several major changes were made in the company's wholly owned insurance subsidiary during 1981. The name changed to K mart Insurance Services, Inc. ("KMI"), the headquarters moved to a more efficient facility and the company chartered a new property/casualty insurance company. These changes were necessary because of the expansion of KMI into new marketing areas. KMI recently began to support various insurance systems of K mart Corporation and will soon be marketing life, health and property/casualty insurance through selected K mart stores. KMI also acts as a third-party administrator to companies that self-insure their workers' compensation coverage. See Note (D) of the accompanying Notes to Consolidated Financial Statements for further information on K mart Insurance Services, Inc.

Inflation Accounting—A discussion of the impact of inflation on the company's sales and earnings is presented on pages 22 through 25.

Financial Condition

Liquidity—K mart Corporation is committed to long-term growth by investing funds retained by the company in suitable projects that show attractive potential returns. To carry on this growth program, the company has maintained a strong position of liquidity over the years as well as a high degree of financial flexibility based primarily on a large flow of funds from operations.

K mart employs a number of criteria to measure the company's liquidity. The company observes the trends in cash flow generation, working capital and the total capitalization of the company.

Cash Flow—Cash flow from operations is a measurement of the company's ability to fund growth in new store openings, refurbishment programs, acquisitions, store merchandising and promotional activity, dividends to shareholders and debt repayment.

A summary of the company's changes in cash position follows:

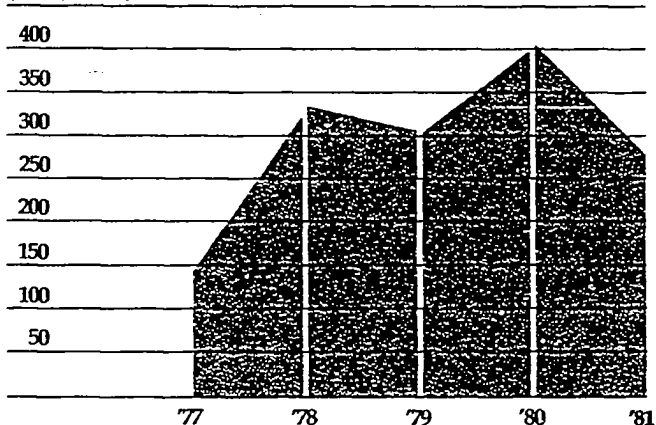
(Millions)	1981	1980	1979
Net cash provided by operations	\$ 278.1	\$ 404.3	\$ 307.7
Net cash provided by financing	314.1	239.1	327.8
Dividends paid	(117.5)	(110.8)	(99.2)
Net cash used for investments	(572.5)	(619.5)	(476.9)
Net increase (decrease) in cash	\$ (97.8)	\$ (86.9)	\$ 59.4

Refer to the company's Consolidated Statements of Changes in Financial Position on page 30 for additional information.

Cash and temporary investments decreased by \$97.8 million and \$86.9 million in 1981 and 1980, respectively. The cash position over the past two years has declined primarily because of reduced net income and increased investment programs.

NET CASH PROVIDED BY OPERATIONS

\$450 (Millions)



Sources and Uses of Funds—Funds from operations, which were \$278.1 million, \$404.3 million and \$307.7 million in 1981, 1980 and 1979, respectively, provided a major source of cash needed to operate the business. In addition, net cash provided by financing was \$314.1 million, \$239.1 million and \$327.8 million in 1981, 1980 and 1979, respectively. During 1980, additional working capital was provided by long-term debt which included an intermediate-term loan in the principal amount of \$200.0 million at an interest rate of 9%. For more information, refer to the company's Consolidated Statements of Changes in Financial Position presented on page 30.

K mart uses commercial paper and revolving bank credit to cover peak working capital requirements. The maximum amounts of aggregate short-term borrowings outstanding during 1981, 1980 and 1979 were \$999.6 million, \$734.0 million and \$651.9 million, respectively. The approximate average short-term borrowings outstanding during 1981, 1980 and 1979 were \$520.5 million, \$499.0 million and \$364.0 million, respectively.

Total short-term lines of credit available and unused were \$852.6 million, \$646.6 million and \$497.0 million at January 27, 1982, January 28, 1981 and January 30, 1980, respectively.

The company anticipates future sources of funds required to finance inventories, store expansion and refurbishing will be primarily from internally generated funds, leasing of land and buildings and short-term borrowings to cover peak working capital requirements.

The following shows the principal uses of funds during the past three years:

(Millions)	1981	1980	1979
Dividends paid	\$117.5	\$110.8	\$ 99.2
Investments			
Addition to property owned	361.4	350.6	291.7
Addition to property leased	178.2	232.8	178.8
Other	32.9	36.1	6.4
Total investments	572.5	619.5	476.9
Total uses of funds	\$690.0	\$730.3	\$576.1

To facilitate the growth of K mart's business, the major use of funds was for the net investment in owned property. Capital expenditures in 1981 of \$361.4 million represented a continuation of the company's commitment to its program of store modernization and expansion of the company's store and distribution center network.

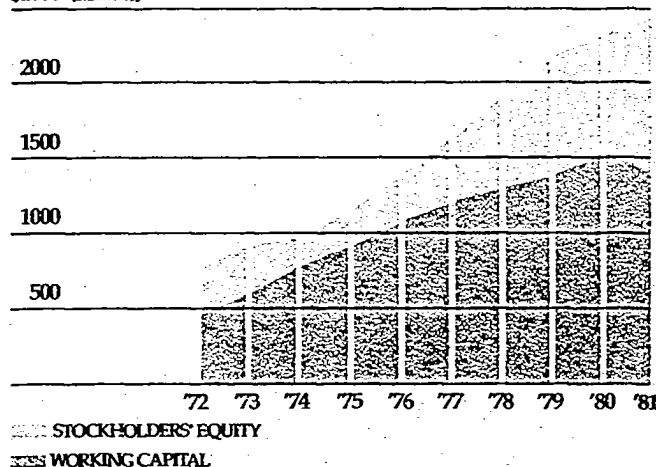
In 1982, the company intends to continue the store refurbishment program and to further improve operating efficiency in store operations. The company anticipates opening approximately 80 K mart stores in 1982 compared with 171 K mart stores opened during 1981. Because of the reduction in the new-store opening program, capital expenditures in 1982 are expected to be below the prior year.

As required by Financial Accounting Standard No. 13, "Accounting for Leases," substantially all lease obligations are capitalized and considered debt-equivalent obligations; therefore, lease obligations are treated as a source and use of funds.

Working Capital—Working capital is defined as the company's total current assets minus current liabilities. Working capital management is indicative of the company's financial flexibility to meet ongoing business obligations.

STOCKHOLDERS' EQUITY AND WORKING CAPITAL

\$2500 (Millions)



An analysis of the changes in working capital follows:

(Millions)	1981	1980	1979
Increase (decrease) in current assets:			
Cash and temporary investments	\$ (97.8)	\$ (86.9)	\$ 59.4
Accounts receivable	10.1	3.5	33.3
Merchandise inventories	289.2	100.3	369.6
Operating supplies and prepaid expenses	14.7	9.9	12.0
	216.2	26.8	474.3
Increase (decrease) in current liabilities:			
Obligations under capital leases and long-term debt due within one year	5.1	5.9	4.8
Notes payable	168.2	(185.5)	185.5
Accounts payable—trade	192.8	2.6	121.9
Accrued payrolls, taxes and other liabilities	12.0	102.9	47.2
Dividends payable	1.4	2.6	3.8
Income taxes	(67.2)	(40.3)	30.8
	312.3	(111.8)	394.0
Increase (decrease) in working capital	\$ (96.1)	\$ 138.6	\$ 80.3

Working capital decreased \$96.1 million in 1981 compared with a \$138.6 million increase in 1980. The decrease in working capital in 1981 was partially due to the acquisition of 44% of Astra, S.A., a wholly owned retail subsidiary of the Gentor Group of Monterrey, Mexico, for \$50.0 million [see Note (B)]. The larger increase in working capital in 1980 was due primarily to the \$200.0 million debt offering in July 1980 offset by expenditures related to the acquisition of Furr's Cafeterias, Inc., for approximately \$70.0 million.

Efficiency in inventory management is indicated by K mart's first-in, first-out ("FIFO") inventory turnover ratio using replacement cost as measured by the FIFO method of inventory. The inventory turnover ratio was 3.5 for 1981 compared with 3.2 for 1980.

The ratio of income to fixed charges, which was 1.9, 2.4 and 3.6 in 1981, 1980 and 1979, respectively, demonstrates the company's ability to cover charges of a fixed nature, consisting primarily of interest expense, in relation to net income.

The current ratio is indicative of K mart's ability to meet short-term obligations. The current ratio of 1.7 for 1981 declined slightly from prior years.

A summary of key working capital activity and liquidity ratios follows:

	1981	1980	1979
Working capital (millions)	\$1,430	\$1,526	\$1,388
Inventory turnover ratio—			
Cost of merchandise sold (FIFO) ÷			
Average inventory (FIFO)	3.5	3.2	3.3
Ratio of income to fixed charges	1.9	2.4	3.6
Current ratio	1.7	1.9	1.8

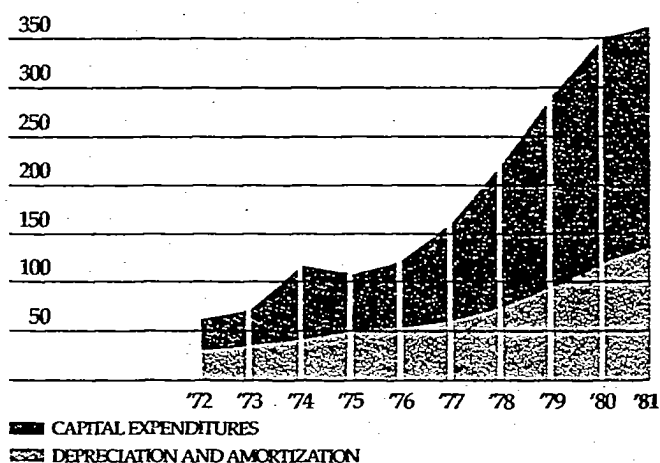
Total Capitalization—The long-term liquidity of K mart is indicated by the debt-to-total-capitalization ratio, which was 46.9%, 46.7% and 43.1% in 1981, 1980 and 1979, respectively.

The following summarizes the total capitalization for K mart:

(Millions)	1981		1980		1979	
	Amount	%	Amount	%	Amount	%
Long-term debt due within one year	\$ 1.8		\$ 1.8		\$ 2.1	.1
Obligations under capital leases due within one year	62.3	1.3	57.2	1.3	50.9	1.3
Long-Term Debt	415.1	8.7	418.7	9.3	209.4	5.4
Obligations under Capital Leases	1,752.0	36.9	1,618.1	36.1	1,422.3	36.3
Total debt and equivalent	2,231.2	46.9	2,095.8	46.7	1,684.7	43.1
Deferred Income Taxes	67.2	1.4	51.6	1.1	42.9	1.1
Equity	2,455.6	51.7	2,343.2	52.2	2,185.2	55.8
Total capitalization	\$4,754.0	100.0	\$4,490.6	100.0	\$3,912.8	100.0

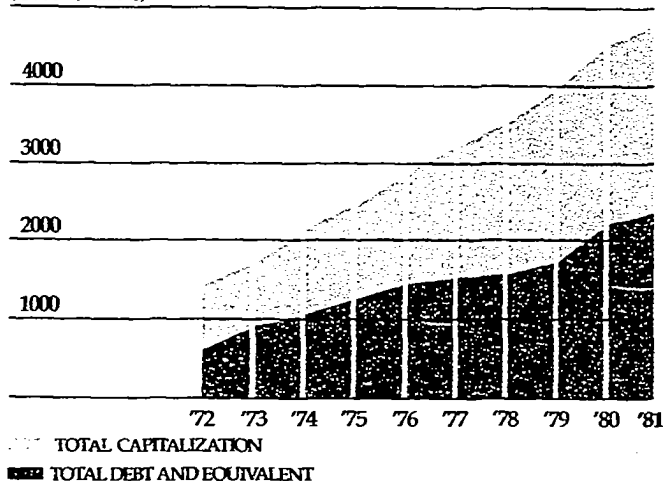
CAPITAL EXPENDITURES AND DEPRECIATION AND AMORTIZATION—OWNED ASSETS

\$400 (Millions)



CAPITALIZATION

\$5000 (Millions)



The company's debt structure (even when capital leases are included) and its strong financial position enhance its ability to obtain necessary funds at the best available rates in worldwide capital markets.

Stockholders' Information

Stockholders' Equity—In 1981, stockholders' equity amounted to \$2.5 billion compared with \$2.3 billion for 1980, an increase of 4.8%. Stockholders' equity per share for 1981 was \$19.81 compared with \$18.99 in 1980. Return on beginning stockholders' equity was 9.4% for 1981 compared with 11.9% for 1980.

Dividends paid to K mart stockholders amounted to \$117.5 million in 1981, an increase of 6.0%, compared with \$110.8 million in 1980. Annual dividends declared per share were \$.96 in 1981 compared with \$.92 for 1980, representing the 17th consecutive increase in annual dividends declared to K mart stockholders.

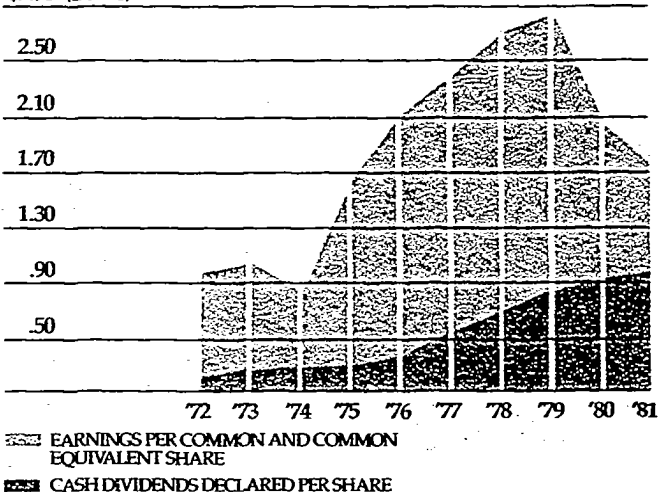
K mart's common stock is listed and traded on the New York and Pacific Stock Exchanges. Shareholders of common stock totaled 108,113 as of January 27, 1982. The following table sets forth the dividends paid per share of common stock and the high and low market prices of the common stock during the past two years:

Year	Quarter	Common Stock Data	
		Fiscal Quarter Dividends	Calendar Quarter Market Price (High-Low)
1981	First	\$.23	20 1/4-16%
	Second	.24	23 3/4-18%
	Third	.24	22 -16%
	Fourth	.24	18 1/2-15%
	Year	\$.95	23 3/4-15%
1980	First	\$.21	24 1/4-17%
	Second	.23	24 -18
	Third	.23	26 1/2-20
	Fourth	.23	21 -15 1/2
	Year	\$.90	26 1/2-15 1/2

Certain of the company's debt agreements have dividend restrictions that are summarized in Note (G) of the accompanying Notes to Consolidated Financial Statements.

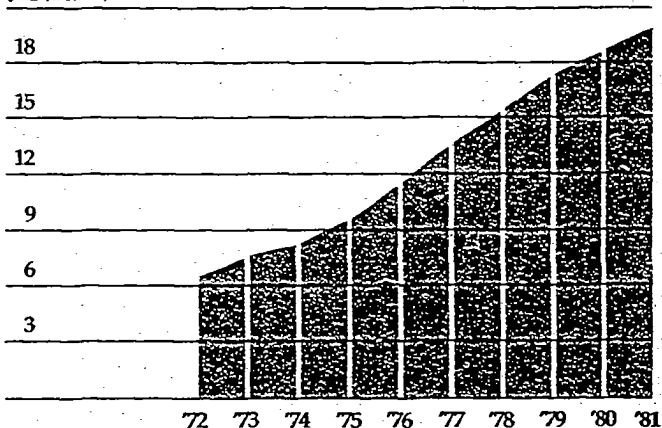
EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE AND CASH DIVIDENDS DECLARED PER SHARE

\$2.90 (Dollars)



STOCKHOLDERS' BOOK VALUE PER SHARE

\$21 (Dollars)



Impact of Inflation (Unaudited)

Introduction—High rates of inflation continued to plague the economy during 1981, further eroding the purchasing power of the dollar and distorting financial information that is prepared on a historical cost basis. To assist readers of financial statements in assessing the impact of inflation, the Financial Accounting Standards Board issued Statement No. 33 ("FAS 33"), "Financial Reporting and Changing Prices," which requires two methods for restating historical cost data originally presented in the financial statements.

An analysis of the two methods follows:

Under "constant dollar" accounting, the historical accounting data is adjusted for "general inflation." Amounts are restated into dollars of the same purchasing power using the Consumer Price Index for All Urban Consumers ("CPI-U"). Constant dollar accounting does not measure how inflation has affected specific asset values or costs for any one corporation, nor is it necessarily representative of the business being measured.

In contrast, the "current cost" method attempts to provide reasonable approximations of changes in specific prices of goods and services applicable to individual corporations from the dates they were acquired to the present. All constant dollar and current cost data are stated in average-for-the-year 1981 dollars.

Under the guidelines of FAS 33, only cost of merchandise sold and depreciation and amortization expenses are required to be adjusted to net income, since these components of the income statement are thought to be most affected by inflation.

Discussion of Results—K mart reports historical net income using the LIFO method of inventory valuation to compute cost of merchandise sold for 86.4% of inventories at January 27, 1982. Most retailers under the LIFO method use the Bureau of Labor Statistics Index ("BLS") as the measure of inflation for the general merchandise retail industry. A comparison of inflationary increases as measured by the CPI-U and BLS is indicated below:

	1981	1980	1979	1978	1977
CPI-U	10.1%	13.3%	11.6%	7.9%	6.6%
BLS	4.7%	6.3%	5.8%	4.9%	3.7%

The lower cost of merchandise sold on a current cost basis reflects the fact that the high rates of inflation in recent years as indicated by the CPI-U have generally outpaced the increase in specific costs of K mart's inventories as measured by the BLS. Consequently for 1981, cost of merchandise sold of \$12.4 billion on a constant dollar basis exceeded the \$12.3 billion on a current cost basis and \$12.2 billion on a historical cost basis.

Also, the increase in current cost of K mart's owned property since the date of acquisition has been less than the increase in general inflation as measured by the CPI-U. Thus for 1981, depreciation of owned properties of \$166.1 million on a current cost basis is less than the \$199.3 million on a constant dollar basis and contrasts to \$140.7 million on a historical cost basis.

Inflation accounting calculations were also made for leased property. Under FAS 33, capitalization of leased property is inflation-affected but operating leases are not. The application of Statement of Financial Accounting Standards No. 13 ("FAS 13"), "Accounting for Leases," is not uniform within the retail industry. Consequently, the

inflation charge for the amortization of capitalized leased assets is not comparable since all leases are not capitalized by all companies.

In accordance with FAS 33, restated net income does not reflect an adjustment to historical dollar income taxes, because present tax laws do not allow deductions for increased dollar cost of merchandise sold and depreciation expense due to inflation. As a result, the effective tax rate for 1981 rises from 33.2% to 234.0% on a constant dollar basis and 57.6% on a current cost basis.

The "unrealized purchasing power gain" on net monetary position is intended to represent the net effect of holding monetary assets (cash, receivables, etc.) and owing money during an inflationary period. The holding of monetary liabilities such as capital lease obligations and long-term debt results in a gain in purchasing power since the obligation will be settled in dollars of lower value. Such gain in purchasing power results from the company's substantial use of capital lease financing that approximates 45.3% of the net amounts owed.

Both the constant dollar and current cost methods involve the use of assumptions, approximations and estimates. Thus, these methods should be viewed in this context and not as a precise indicator of the effects of inflation upon K mart Corporation.

The company believes that the CPI-U is not a reliable measure of inflation for the retail industry. The CPI-U reflects such items as housing and fuel costs that have risen dramatically in recent years.

Thus, of the two presentations, the company believes that the current cost method probably comes closer to depicting the general level of inflation on operations.

Statements of Income Adjusted for Changing Prices

Fiscal Year Ended January 27, 1982

(\$ in Millions, except per share amounts)	As Reported in the Primary Statements (Historical Cost)	Adjusted for General Inflation (Constant Dollar- CPI-U)	Adjusted for Changes in Specific Prices (Current Cost)
Sales	\$16,527.0	\$16,527.0	\$16,527.0
Licensee fees and rental income	151.6	151.6	151.6
Equity in income of affiliated retail companies	44.4	44.4	44.4
Interest income	45.7	45.7	45.7
	16,768.7	16,768.7	16,768.7
Cost of merchandise sold, excluding depreciation and amortization	12,248.4	12,396.7	12,280.1
Depreciation of property owned	140.7	199.3	166.1
Amortization of leased property under capital leases	88.9	159.1	168.5
Other costs and expenses	3,967.8	3,967.8	3,967.8
	16,445.8	16,722.9	16,582.5
Income before estimated income taxes	322.9	45.8	186.2
Estimated income taxes	107.2	107.2	107.2
Income (loss) from retail operations	215.7	(61.4)	79.0
Equity in income of insurance operations	4.6	4.6	4.6
Net income (loss)	\$ 220.3	\$ (56.8)	\$ 83.6
Earnings (loss) per common and common equivalent share	\$1.75	\$(.39)	\$.70
Unrealized gain from decline in purchasing power of net amounts owed		\$ 299.9	\$ 299.9
Increase in specific prices (current cost) of merchandise inventories, property owned and leased			\$ 803.9
Increase in general price level (constant dollar)			602.7
Increase in specific prices of inventory and property over increase in the general price level			\$ 201.2

At January 27, 1982, current cost of merchandise inventories was \$3,590.5 million, current cost of property owned, net of accumulated depreciation, was \$1,519.5 million, and current cost of leased property under capital leases, net of accumulated amortization, was \$3,031.8 million.

Five-Year Comparison of Selected Supplementary Financial Data
Adjusted for Effects of Changing Prices
(Millions U.S. \$, except per share amounts, of average fiscal 1981 dollars)

	Fiscal Year Ended				
	January 27, 1982	January 28, 1981	January 30, 1980	January 31, 1979*	January 25, 1978
Net sales and other operating revenue (excluding interest income):					
U.S. and Canada	\$16,701.4	\$15,815.0	\$16,070.1	\$15,904.1	\$14,568.4
Australia**	\$ 21.6**	\$ 14.0**	\$ 17.5**	\$ 576.3	\$ 463.7
Net income (loss):					
Constant dollar	\$ (56.8)	\$ (96.2)	\$ 14.7		
Current cost	\$ 83.6	\$ 182.0	\$ 334.3		
Earnings (loss) per share:					
Constant dollar	\$ (.39)	\$ (.70)	\$.17		
Current cost	\$.70	\$ 1.46	\$ 2.66		
Net assets:					
Constant dollar	\$ 4,265.1	\$ 4,146.7	\$ 3,999.7		
Current cost	\$ 4,704.2	\$ 4,320.9	\$ 4,202.3		
Increase in specific prices of inventory and property over (under) increase in the general price level	\$ 201.2	\$ (239.8)	\$ (577.6)		
Gain from decline in purchasing power of net amounts owed	\$ 299.9	\$ 397.8	\$ 462.7		
Cash dividends declared per share in constant dollars	\$.96	\$ 1.01	\$ 1.05	\$ 1.00	\$.84
Market price per share at year-end in constant dollars	\$ 15	\$ 18	\$ 25	\$ 33	\$ 37
Average Consumer Price Index (constant dollar)	274.2	249.1	219.8	196.9	182.5

Constant dollar information is adjusted for general inflation as measured by the CPI-U and current cost information is adjusted for changes in specific prices.

*53 weeks

**Due to restructuring of the company's investment in Australian retail operations in December 1978, Australian sales are not consolidated in 1981, 1980 and 1979.

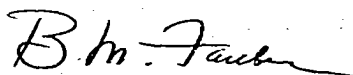
Reports by Management and Independent Accountants

Kmart Responsibility for Financial Statements

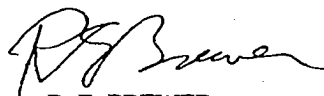
Kmart Corporation management is responsible for the integrity of the information and representations contained in this annual report. Management believes the financial statements are in conformity with generally accepted accounting principles and have been prepared on a consistent basis. This responsibility included making informed estimates and judgments in selecting the appropriate accounting principles in the circumstances.

To assist management in fulfilling these obligations, the company utilizes several tools, which include the following:

- The company maintains a system of internal accounting controls to provide reasonable assurance that, among other things, financial records are reliable for purposes of preparing financial statements and that assets are properly accounted for and safeguarded. This concept of reasonable assurance is based on the recognition that the cost of the system must be related to the benefits to be derived. Management believes its system provides this appropriate balance.
- An Internal Audit Department is maintained to evaluate, test and report the application of internal accounting controls in conformity with the standards for the practice of internal auditing.
- The Board of Directors appointed our independent accountants to perform an examination of the company's financial statements. This examination included, among other things, a review of the system of internal controls as required by generally accepted auditing standards.
- The Audit Committee of the Board of Directors, consisting solely of outside directors, meets regularly with management, internal auditors and independent accountants to assure that each is carrying out its responsibilities. The internal auditors and independent accountants both have full and free access to the Audit Committee, with and without the presence of management.



B. M. FAUBER
Chairman of the Board
and Chief Executive Officer



R. E. BREWER
Executive Vice President
Finance

Report of Independent Accountants

To the Stockholders and Board of Directors of Kmart Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of income retained for use in the business and of changes in financial position present fairly the financial position of Kmart Corporation and its subsidiaries at January 27, 1982 and January 28, 1981, and the results of their operations and the changes in their financial position for each of the three fiscal years in the period ended January 27, 1982, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.



200 Renaissance Center
Detroit, Michigan
March 10, 1982

Consolidated Statements of Income

(Thousands)	Fiscal Year Ended		
	January 27, 1982	January 28, 1981	January 30, 1980
Sales	\$16,527,012	\$14,204,381	\$12,731,145
Licensee fees and rental income	151,572	138,176	127,440
Equity in income of affiliated retail companies	44,405	37,444	37,351
Interest income	45,677	26,693	21,395
	16,768,666	14,406,694	12,917,331
Cost of merchandise sold (including buying and occupancy costs)	12,360,451	10,417,144	9,282,764
Advertising	385,704	339,009	301,485
Selling, general and administrative expenses	3,423,961	2,987,108	2,537,522
Interest expense:			
Debt	114,884	92,078	50,640
Capital lease obligations	160,745	134,957	120,325
	16,445,745	13,970,296	12,292,736
Income before estimated income taxes	322,921	436,398	624,595
Estimated income taxes:			
U.S.	73,938	144,583	222,746
Foreign	4,391	12,174	13,632
State and local	17,103	25,877	31,320
Tax effects of timing differences	11,833	(1,847)	2,351
	107,265	180,787	270,049
Income from retail operations	215,656	255,611	354,546
Equity in income of insurance operations	4,595	4,916	3,453
Net income for the year	\$ 220,251	\$ 260,527	\$ 357,999
Earnings per common and common equivalent share	\$1.75	\$2.07	\$2.84

Consolidated Statements of Income Retained for Use in the Business

(Thousands)	Fiscal Year Ended		
	January 27, 1982	January 28, 1981	January 30, 1980
Income retained for use in the business at beginning of year	\$ 1,966,032	\$ 1,818,888	\$ 1,563,925
Net income for the year	220,251	260,527	357,999
Cash dividends declared—\$.96, \$.92 and \$.84, respectively	(118,874)	(113,383)	(103,036)
Income retained for use in the business at end of year	\$ 2,067,409	\$ 1,966,032	\$ 1,818,888

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

(Thousands)

Assets	January 27, 1982	January 28, 1981
Current Assets:		
Cash (includes temporary investments of \$48,216 in 1981 and \$139,874 in 1980)	\$ 115,202	\$ 212,987
Accounts receivable	89,878	79,783
Merchandise inventories	3,135,104	2,845,910
Operating supplies and prepaid expenses	73,378	58,651
Total current assets	3,413,562	3,197,331
Investments in and Advances to:		
Affiliated retail companies	210,725	137,992
Insurance operations	99,581	88,062
Other Assets and Deferred Charges	73,403	77,705
Property:		
Land	45,261	43,861
Buildings	177,063	172,743
Leasehold improvements	258,069	224,099
Furniture and fixtures	1,475,959	1,261,199
Construction in progress	58,742	44,087
	2,015,094	1,745,989
Less—Depreciation and amortization	760,175	654,895
Total property owned	1,254,919	1,091,094
Leased property under capital leases, less accumulated amortization of \$629,144 and \$563,904, respectively	1,620,814	1,510,278
Total property	2,875,733	2,601,372
	\$6,673,004	\$6,102,462

See Notes to Consolidated Financial Statements.

Liabilities and Stockholders' Equity	January 27, 1982	January 28, 1981
Current Liabilities:		
Long-term debt due within one year	\$ 1,777	\$ 1,845
Obligations under capital leases due within one year	62,322	57,153
Notes payable	168,154	
Accounts payable—trade	1,252,975	1,060,185
Accrued payrolls and other liabilities	269,995	269,472
Taxes other than income taxes	145,320	133,744
Dividends payable	29,754	28,377
Income taxes	52,895	120,068
Total current liabilities	1,983,192	1,670,844
 Obligations under Capital Leases	 1,751,961	 1,618,143
 Long-Term Debt	 415,077	 418,726
 Deferred Income Taxes	 67,180	 51,577
 Stockholders' Equity:		
Common stock	123,976	123,379
Capital in excess of par value	264,209	253,761
Income retained for use in the business	2,067,409	1,966,032
Total stockholders' equity	2,455,594	2,343,172
	\$6,673,004	\$6,102,462

Consolidated Statements of Changes in Financial Position

(Thousands)	Fiscal Year Ended		
	January 27, 1982	January 28, 1981	January 30, 1980
Cash Provided by (Used for):			
<i>Operations</i>			
Net income for the year	\$ 220,251	\$ 260,527	\$ 357,999
Non-cash charges (credits) to earnings—			
Depreciation and amortization:			
Property owned	140,652	118,812	93,326
Leased property under capital leases	88,899	78,994	72,228
Deferred income taxes	11,833	(1,847)	2,351
Equity in undistributed income of affiliated retail companies and insurance operations	(16,532)	(16,210)	(17,133)
Other	5,524	2,092	2,249
Total from net income	450,627	442,368	511,020
Cash provided by (used for) current assets and liabilities:			
Increase in inventories	(289,194)	(100,348)	(369,665)
Increase in accounts payable	192,790	2,629	121,865
Net change in other current assets and other current liabilities	(76,126)	59,677	44,476
Net cash provided by operations	278,097	404,326	307,696
<i>Financing</i>			
Increase in long-term debt and notes payable	168,154	215,512	185,540
Reduction in long-term debt and notes payable	(3,982)	(192,164)	(2,538)
Obligations incurred under capital leases	197,910	266,688	178,814
Reduction in capital lease obligations	(59,052)	(61,716)	(48,590)
Sale of common stock under stock option and purchase plans	11,030	10,796	14,563
Net cash provided by financing	314,060	239,116	327,789
<i>Dividends Paid</i>	(117,497)	(110,802)	(99,226)
<i>Investments</i>			
Property additions:			
Property owned (including \$48,689 in 1980 related to acquired subsidiary)	(361,377)	(350,639)	(291,672)
Leased property under capital leases	(178,215)	(232,757)	(178,814)
Proceeds from the sale of property	38,144	11,749	13,088
Increases in investments in and advances to affiliated retail companies and insurance operations	(68,245)	(7,045)	(9,097)
Excess of cost over acquired net assets		(17,186)	
Other—net	(2,752)	(23,671)	(10,391)
Net cash used for investments	(572,445)	(619,549)	(476,886)
Net Increase (Decrease) in Cash and Temporary Investments	\$ (97,785)	\$ (86,909)	\$ 59,373

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(A) Summary of Significant Accounting Policies

Fiscal Year: The company's fiscal year ends on the last Wednesday in January. Fiscal years 1981, 1980 and 1979 all consisted of 52 weeks and ended on January 27, 1982, January 28, 1981 and January 30, 1980, respectively.

Basis of Consolidation: The company includes all majority-owned retail subsidiaries in the consolidated financial statements. Investments in affiliated retail companies owned 20% or more and the wholly owned insurance operations are accounted for by the equity method using their December financial statements. All significant intercompany transactions and accounts have been eliminated in consolidation.

Foreign Operations: The company translates substantially all foreign currency accounts into U.S. dollars at exchange rates in effect at the end of each period for current assets (excluding inventories) and for substantially all liabilities; at historical exchange rates for inventories, owned property, leased property and the related depreciation and amortization and all other noncurrent assets; and at average exchange rates during the period for revenue and expenses. Exchange gains or losses are included in net income.

Inventories: Merchandise inventories are valued at the lower of cost or market, using the retail method, on the last-in, first-out basis for substantially all domestic inventories and the first-in, first-out basis for the remainder.

Property Owned: Land, buildings, leasehold improvements and equipment are recorded at cost. Major replacements and refurbishings are charged to the property accounts while replacements, maintenance and repairs which do not improve or extend the life of the respective assets are expensed currently. The company capitalizes interest cost as part of the cost of constructing capital assets.

Generally, in the case of ordinary retirements, the cost of properties is charged to the allowance for depreciation and, in the case of extraordinary retirements such as those resulting from abandonments of locations and complete rebuilding at locations, the cost of properties retired and the accumulated depreciation thereon are eliminated from the accounts and the resulting gain or loss is taken into income.

Depreciation: The company computes depreciation on owned property principally on the straight-line method for financial statement purposes and on accelerated methods for income tax purposes. Most store properties are leased, and improvements are amortized over the term of the lease but

not more than 25 years. Other annual rates used in computing depreciation for financial statement purposes are 2% to 5% for buildings, 10% for store fixtures and 5% to 33% for other fixtures and equipment.

Leased Property under Capital Leases: The company accounts for capital leases, which transfer substantially all of the benefits and risks incident to the ownership of property, as an acquisition of an asset and the incurrence of an obligation. Under this method of accounting for leases, the asset is amortized using the straight-line method and the obligation, including interest thereon, is liquidated over the life of the lease. All other leases (operating leases) are accounted for by recording periodic rental expense over the life of the lease.

Licensee Sales: The company's policy is to exclude sales of licensed departments from total sales.

Pre-Opening Costs: The company follows the practice of treating as current period expenses those store operating costs incurred prior to opening a new retail unit.

Income Taxes: Deferred income taxes are provided on non-permanent differences between financial statement and taxable income.

The company accrues appropriate U.S. and foreign taxes payable upon all of the earnings of subsidiaries and affiliates, except with respect to earnings which are intended to be permanently reinvested. Any additional taxes or credits related to subsequent distributions of such earnings are determined and taken into account at the time of distribution.

Investment Credit: The company uses the "flow through" method of accounting for investment credit whereby income tax expense is reduced for the period in which expenditures create the tax benefit.

Change in Presentation: In 1981, the company changed its presentation of the Consolidated Statements of Changes in Financial Position from a working capital format to a cash format. The Consolidated Statements of Changes in Financial Position for 1980 and 1979 have been reclassified to conform with the 1981 presentation.

(B) Acquisitions

On September 4, 1981, K mart Corporation acquired, for \$50.0 million in cash, 44% of Astra, S.A. ("Astra"), which was previously a wholly owned retailing subsidiary of the Gentor Group of Monterrey, Mexico. Astra is a holding company of certain Mexican companies which primarily operate retail food and general merchandise stores in Mexico. Excess of cost over acquired net assets of approximately \$33.0 million is being amortized over a 40-year period under the straight-line method. The investment is accounted for using the equity method and accordingly, the company's equity in Astra's earnings since the acquisition date, which is not material to the consolidated financial statements, is included in income.

Effective in the second quarter of 1980, the company, through a wholly owned subsidiary, acquired for \$70.0 million in cash, Furr's Cafeterias, Inc. ("Furr's"). Furr's operates a chain of cafeterias in the southwestern portion of the United States. The acquisition has been accounted for as a purchase and accordingly the results of the acquired company have been included in income from the date of acquisition. Excess of cost over acquired net assets of \$17.2 million, which is included in other assets and deferred charges, is being amortized over a 40-year period under the straight-line method.

In November 1979, K mart Canada Limited, a subsidiary of the company, acquired for \$11.6 million in cash, S.C.C. Shoe Corporation of Canada, Ltd. ("SCC") and Canmart Shoe Limited ("Canmart"). SCC and Canmart operate the footwear departments in Canadian K marts and also operate a number of leased footwear departments in conventional department stores and separate retail locations. The acquisition has been accounted for as a purchase and accordingly the results of the acquired companies have been included in income from the date of acquisition.

[See Note (I).]

Results of operations of the above companies prior to the dates of acquisition are not material in relation to the consolidated financial statements.

(C) Merchandise Inventories

A summary of inventories by method of pricing and the excess of current cost over stated LIFO value follows:

(Millions)	January 27, 1982	January 28, 1981
Last-in, first-out (cost not in excess of market)	\$2,646.1	\$2,393.9
Lower of cost (first-in, first-out) or market	489.0	452.0
Total	\$3,135.1	\$2,845.9
Excess of current cost over stated LIFO value	\$ 455.3	\$ 315.9

(D) Equity Company Information

All K mart footwear departments in the United States are operated under licensee agreements with the Meldisco subsidiaries of the Melville Corporation, substantially all of which are 49% owned by the company and 51% owned by Melville. Fees and income earned under the licensee agreements in 1981, 1980 and 1979 of \$102.4 million, \$94.2 million and \$85.4 million, respectively, are included in licensee fees and rental income. The company's equity in the income of these operations and dividends received in 1981, 1980 and 1979 were as follows:

(Millions)	1981	1980	1979
Equity in income of Meldisco operations	\$ 27.7	\$ 26.5	\$ 24.6
Dividends	\$ 25.0	\$ 19.9	\$ 18.2

Meldisco subsidiaries summarized financial information follows:

(Millions)	Year Ended December 31,		
	1981	1980	1979
Sales	\$688.6	\$629.2	\$572.7
Net income	\$ 57.2	\$ 54.2	\$ 51.8

(Millions)	December 31,		
	1981	1980	1979
Inventory	\$ 83.8	\$ 83.0	\$ 73.5
Other assets	68.4	59.1	51.6
Total assets	152.2	142.1	125.1
Liabilities	22.0	19.8	19.0
Net assets	\$130.2	\$122.3	\$106.1
Equity of K mart Corporation	\$ 62.7	\$ 58.4	\$ 49.9

The company has a 20% equity interest in G. J. Coles & Coy. Limited ("Coles"), the major food and general merchandise retailer in Australia. Income earned under the K mart license agreement in 1981, 1980 and 1979 of \$2.3 million, \$1.7 million and \$1.3 million, respectively, is included in licensee fees and rental income. The company's equity in the income of Coles' operations, dividends and year-end investment in Coles are as follows:

(Millions U.S. \$)	1981	1980	1979
Equity income	\$19.3	\$11.0	\$12.8
Dividends	\$ 7.5	\$ 6.2	\$ 5.5
Equity of K mart Corporation	\$94.6	\$79.6	\$72.9

As of January 27, 1982, the market value of Coles' common stock owned by the company in U.S. dollars was approximately \$105.4 million. Coles' accounts as reported in Australia have been translated into U.S. dollars at the current exchange rates at January 27, 1982. Summarized financial information for their fiscal years is as follows:

(Millions U.S. \$)	July 1981 (52 Weeks)	July 1980 (52 Weeks)	July 1979 (57 Weeks)
Sales	\$3,570.9	\$2,934.9	\$2,636.8
Net income	\$ 75.6	\$ 60.2	\$ 61.4
Total assets	\$ 925.3	\$ 782.1	\$ 666.3

K mart Insurance Services, Inc. (formerly Planned Marketing Associates, Inc.) summarized financial information with respect to insurance operations follows:

(Millions)	Year Ended December 31,		
	1981	1980	1979
Premium and other income	\$ 71.2	\$ 66.8	\$ 62.3
Costs and expenses	66.6	61.9	58.8
Net income	\$ 4.6	\$ 4.9	\$ 3.5

(Millions)	December 31,		
	1981	1980	1979
Cash and receivables	\$ 11.7	\$ 12.8	\$ 30.4
Investments	141.7	123.6	88.2
Policy acquisition costs and other assets	65.4	58.4	53.6
Total assets	218.8	194.8	172.2
Policy and claim reserves	103.7	92.7	81.2
Other liabilities	15.5	14.0	11.2
Equity of K mart Corporation	\$ 99.6	\$ 88.1	\$ 79.8

Unremitted earnings of unconsolidated subsidiaries included in consolidated retained earnings were \$80.2 million at January 27, 1982.

(E) Compensating Balances and Current Notes Payable

At January 27, 1982, notes payable included \$167.4 million of the company's commercial paper (weighted average interest rate 13.7%) and \$.7 million of notes payable to banks (weighted average interest rate 16.5%).

At January 27, 1982, the company had bank lines of credit aggregating \$853.3 million with interest rates approximating the "prime" lending rate. In support of certain lines of credit, it is expected that compensating balances will be maintained on deposit with the banks, which will average 10% of the line to the extent that it is not in use and an additional 10% on the portion in use whereas other lines require fees in lieu of compensating balances. The company is free to withdraw the entire balance in its accounts at any time.

(F) Estimated Income Taxes

The effective income tax rate is reconciled to the Federal statutory rate as follows:

	Fiscal Year Ended		
(Millions U.S. \$)	January 27, 1982	January 28, 1981	January 30, 1980
Income before estimated income taxes:			
U.S.	\$296.1	\$403.4	\$587.5
Foreign	26.8	33.0	37.1
Total	\$322.9	\$436.4	\$624.6
Tax thereon, computed at statutory rate of 46%	\$148.5	\$200.7	\$287.3
Increases (reductions) in taxes resulting from:			
State and local income taxes, net of federal income tax benefit	9.2	13.9	16.9
Tax credits	(28.4)	(21.2)	(19.7)
Equity in income of affiliated retail companies subject to lower tax rates	(18.6)	(14.7)	(14.1)
Other	(3.4)	2.1	(.4)
Estimated income taxes	\$107.3	\$180.8	\$270.0
Effective rate	33.2%	41.4%	43.2%
Tax effects of timing differences are:			
Accelerated depreciation	\$ 32.4	\$ 17.8	\$ 21.4
Capitalized leases	(14.5)	(12.5)	(11.4)
Other	(6.1)	(7.1)	(7.6)
Total	\$ 11.8	\$ (1.8)	\$ 2.4

The amounts shown on the balance sheets for deferred income taxes result principally from the difference between financial statement and income tax depreciation, reduced by the effect of accounting for certain leases as capital leases of \$97.3 million at January 27, 1982. The net amount of current deferred taxes at January 27, 1982 and January 28, 1981 was \$26.8 million and \$23.0 million, respectively, which relates principally to accrued employee benefits and uninsured claims and is included in operating supplies and prepaid expenses.

Undistributed earnings of subsidiaries which are intended to be permanently reinvested totaled \$169.9 million at January 27, 1982.

(G) Long-Term Debt

(Millions)	January 27, 1982	January 28, 1981
9% notes due 1985 (net of unamortized discount of \$1.0 million and \$1.2 million, respectively)	\$199.0	\$198.8
6% convertible subordinated debentures due 1999	199.9	200.0
4% notes payable in varying amounts through December 16, 1983, \$1.3 million due within one year	3.5	4.8
Other	14.5	16.9
	416.9	420.5
Portion due within one year	1.8	1.8
Total	\$415.1	\$418.7

The 9% notes due July 15, 1985 are unsecured obligations of the company and may be redeemed beginning in 1983 at a redemption price equal to 100% of the principal amount plus accrued interest.

The debentures due 1999 are convertible into common stock at \$35.50 per share. The indenture relating to the debentures provides that the company shall pay \$11.0 million into a sinking fund on July 15 each year from 1985 to 1998, inclusive. The debentures are subject to redemption through the sinking fund at 100% of the principal amount, or at any time at the option of the company at prices declining from 106% to 100% of the principal amount after July 15, 1994. At January 27, 1982, a total of 5,631,975 shares of authorized common stock are reserved for conversion.

Under the 4% note agreement, \$732.3 million of income retained for use in the business at January 27, 1982 is available for payment of cash dividends.

Principal payments on long-term debt for the five years subsequent to 1981, in millions, are: 1982—\$1.8; 1983—\$3.4; 1984—\$1.1; 1985—\$211.9; 1986—\$14.7.

(H) Leases

Description of Leasing Arrangements: The company conducts operations primarily in leased facilities. Store leases are generally for terms of 25 years with multiple five-year renewal options which allow the company the option to extend the life of the lease up to 50 years beyond the initial noncancellable term. Certain leases provide for additional rental payments based on sales volume in excess of a specified base. Also, certain leases provide for the payment by the lessee of executory costs (taxes, maintenance and insurance), and selling space has been sublet to other retailers in certain of the company's leased facilities.

Lease Commitments: Future minimum lease payments with respect to capital and operating leases are:

(Millions)	Minimum Lease Payments	
	Capital	Operating
Fiscal Year:		
1982	\$ 306.9	\$ 171.3
1983	303.7	168.8
1984	300.5	165.2
1985	296.6	161.8
1986	290.6	158.8
Later years	4,023.5	2,115.4
Total minimum lease payments	5,521.8	2,941.3
Less—minimum sublease rental income		(151.2)
Net minimum lease payments	5,521.8	\$2,790.1
Less:		
Amount representing estimated executory costs		(1,514.0)
Amount representing interest		(2,193.5)
Present value of minimum lease payments, of which \$62.3 million is due within one year	\$ 1,814.3	

The company has guaranteed indebtedness related to certain leased properties financed by industrial revenue bonds. As of January 27, 1982 the total amount of such guaranteed indebtedness is \$198.3 million, of which \$89.6 million is included in capital lease obligations.

Rental Expense: A summary of operating lease rental expense, estimated executory costs of all leases and short-term rentals follows:

(Millions)	Fiscal Year Ended		
	January 27, 1982	January 28, 1981	January 30, 1980
Minimum rentals	\$250.6	\$217.2	\$190.2
Rentals based on sales volume	33.3	27.9	25.6
Less—sublease rentals	(32.6)	(28.9)	(26.2)
Total	\$251.3	\$216.2	\$189.6

Reconciliation of Capital Lease Information: Capital lease amortization and interest charged to operations are reconciled to minimum capital lease payments as follows:

(Millions)	Fiscal Year Ended		
	January 27, 1982	January 28, 1981	January 30, 1980
Amortization of leased property under capital leases	\$ 88.9	\$ 79.0	\$ 72.2
Interest expense related to obligations under capital leases	160.7	135.0	120.3
Amounts charged to earnings	249.6	214.0	192.5
Related minimum lease payments (excluding executory costs)	(219.8)	(188.1)	(168.9)
Excess of amounts charged over related minimum lease payments	\$ 29.8	\$ 25.9	\$ 23.6

The inclusion of capital leases of foreign operations reduced currency fluctuation gains by \$.1 million in 1981, reduced currency fluctuation losses by \$2.9 million in 1980 and increased currency fluctuation losses by \$2.5 million in 1979. [See Note (I).]

(I) Segment and Geographic Information

The dominant portion of the company's operations is in a single industry, retailing general merchandise through the operation of a chain of discount department stores.

The company has both domestic and foreign operations, which are summarized as follows:

(Millions U.S. \$)	1981	1980	1979
Sales:			
U.S.	\$15,752.3	\$13,467.7	\$12,077.5
Canada	774.7	736.7	653.6
Total	\$16,527.0	\$14,204.4	\$12,731.1
Licensee fees and other income:			
U.S.	\$ 216.9	\$ 186.0	\$ 165.3
Canada	3.2	3.6	6.8
Australia	21.6	12.7	14.1
Total	\$ 241.7	\$ 202.3	\$ 186.2
Income from retail operations:			
U.S.	\$ 191.0	\$ 232.0	\$ 329.6
Canada	4.6	12.1	12.4
Australia	20.1	11.5	12.5
	215.7	255.6	354.5
Equity in income of insurance operations	4.6	4.9	3.5
Net income for the year	\$ 220.3	\$ 260.5	\$ 358.0
Identifiable assets:			
U.S.	\$ 5,998.6	\$ 5,498.6	\$ 5,087.4
Canada	364.1	377.8	352.4
	6,362.7	5,876.4	5,439.8
Investments in and advances to:			
Affiliated retail companies—			
U.S.	62.7	58.4	49.9
Australia	94.6	79.6	72.9
Mexico	53.4		
Insurance operations	99.6	88.1	79.8
Total assets	\$ 6,673.0	\$ 6,102.5	\$ 5,642.4

Operating results of certain foreign operations, which are not significant, are included in U.S. amounts.

The company's equity in income in G. J. Coles & Coy. Limited ("Coles") of Australia and license fees from Coles are included under the caption "Licensee fees and other income." [See Note (D).]

Effective November 18, 1979, Kmart Canada Limited acquired S.C.C. Shoe Corporation of Canada, Ltd. and Canmart Shoe Limited. Results of operations since the date of acquisition are included for Canada.

Currency fluctuations, which are included in income from retail operations, reflect the effect of exchange rate changes recognized when financial statements of foreign operations are translated into U.S. dollars. Currency fluctuations, including amounts reported in Australian equity income, consisted of a gain of \$1.2 million in 1981 and losses of \$3.1 million in 1980 and \$1.5 million in 1979.

Identifiable assets are those assets of the company that are identified with operations in a specific geographic area. Corporate assets (assets which are used by two or more geographic operations) and transfers between geographic areas are insignificant.

(J) Stockholders' Equity

Changes in stockholders' equity other than income retained for use in the business for the three fiscal years ended January 27, 1982, were as follows:

(\$ in Millions)	Common Stock (Authorized 250,000,000 Shares \$1.00 Par Value)		
	Shares Outstanding	Amount	Capital in Excess of Par Value
Balance January 31, 1979	122,142,204	\$122.1	\$229.6
Common stock sold under stock option and purchase plans and conversion of debentures	694,305	.7	13.9
Balance January 30, 1980	122,836,509	122.8	243.5
Common stock sold under stock option and purchase plans and conversion of debentures	542,092	.6	10.3
Balance January 28, 1981	123,378,601	123.4	253.8
Common stock sold under stock option and purchase plans and conversion of debentures	597,785	.6	10.4
Balance January 27, 1982	123,976,386	\$124.0	\$264.2

Ten million shares of no par value preferred stock with voting and cumulative dividend rights are authorized but unissued. Currently, there are no plans for its issuance.

At January 27, 1982, there was a total of 11,853,414 shares of common stock reserved for possible issuance under the company's Stock Option Plan, Stock Purchase Incentive Plan, Performance Award Stock Plan and for conversion of the 6% convertible subordinated debentures.

(K) Earnings Per Common and Common Equivalent Share
Earnings per common and common equivalent share were computed by dividing net income by the weighted average number of shares of common stock and dilutive common stock equivalents outstanding during each year. In making the computation for 1981, 1980 and 1979, common shares at the beginning of the year were increased by the number of shares issuable on conversion of the 6% convertible debentures (issued in 1974) and net income was adjusted for interest expense net of the related tax effect. The number of common shares in all years was increased by the number of shares issuable under the Stock Option and Stock Purchase Incentive Plans, less the number of shares which were assumed to have been purchased at average market prices with the proceeds of sales under the plans.

(L) Pension Plans

The company and its subsidiaries have noncontributory pension plans covering most employees. Total pension expense was \$40.8 million for 1981 and \$37.9 million for 1980 (including amortization of prior service costs principally over 30 years), and \$43.6 million for 1979. The company's policy is to fund pension costs accrued.

During 1980, the company changed certain actuarial assumptions to more closely approximate actual experience of the plans. These changes consisted of increases in the assumed interest rate, salary scales and social security benefits along with revision of the withdrawal assumptions. The effect of these changes was to reduce pension expense by approximately \$15.6 million compared with previous actuarial assumptions.

A comparison of accumulated benefits and net assets for the company's pension plan as of the most recent valuation dates is as follows:

(Millions)	January 28, 1981	January 30, 1980
Actuarial present value of accumulated plan benefits:		
Vested	\$207.5	\$180.6
Nonvested	61.4	54.6
Total	\$268.9	\$235.2
Net assets available for benefits	\$331.3	\$261.9

The weighted average assumed rate of return used in determining the actuarial value of accumulated plan benefits was 7.0% for both years.

(M) Stock Purchase Incentive, Option and Performance Award Plans

Information on these plans is summarized below:

Stock Purchase Incentive Plan

	Number of Shares	
	1981	1980
Shares available for purchase at beginning of year	2,330,317	2,870,924
Shares purchased during the year through payroll deductions at \$18.23 per share in 1981 and \$19.34 per share in 1980	(597,363)	(540,607)
Shares available for purchase at end of year	1,732,954	2,330,317

Under the Stock Purchase Incentive Plan approved by the stockholders in May 1976 and amended in May 1981, employees of the company or of certain subsidiaries who have completed one year of service are eligible to purchase up to 4,500,000 shares of common stock through June 1982, at the lower of 85% of the market value on the first or last day of each plan year.

During 1981 the stockholders approved the adoption of a new Employee Savings Plan scheduled to commence on July 1, 1982 upon termination of the Stock Purchase Incentive Plan. Under the terms of the plan, employees who have completed two years of service can invest from 2% to 10% of their earnings in the employees' choice of a diversified common stock fund, an insured guaranteed investment fund, or in Kmart stock. Further, for each dollar the employee invests up to 6% of their earnings, Kmart will contribute an additional 50 cents to be invested in Kmart stock. The company's contribution will be accounted for as compensation expense.

Stock Option Plan

	Number of Shares	
	1981	1980
Available for grant at beginning of year	520,105	1,245,925
Under option at beginning of year (\$19.31 to \$37.63 per share)	2,468,380	1,742,920
Options:		
Granted (\$19.31 to \$19.56 per share)	158,000	797,200
Exercised (\$19.31 per share)		360
Cancelled (\$19.31 to \$37.63 per share)	56,700	71,380
Under option at end of year (\$19.31 to \$37.63 per share)	2,569,680	2,468,380
Options exercisable at end of year (\$19.31 to \$37.63 per share)	1,996,020	1,844,940
Available for grant at end of year	418,805	520,105

Under the company's Stock Option Plan, which was approved by stockholders in June 1973 and amended in 1978 and 1980, options to acquire up to 3,000,000 shares of common stock may be granted to officers and key employees at 100% of the fair value on the date of grant.

Options under the plan may have a maximum term of ten years and are exercisable in annual installments, except that options granted to optionees over age 61 at the date of grant are exercisable in total at such date. Payment upon exercise of an option may be made in cash, already-owned shares or a combination of both. Such shares will be valued at their fair market value as of the date of exercise.

The plan provides for stock appreciation rights (SARs) in tandem with stock options for officers and eligible directors who are limited under the Securities Exchange Act of 1934 in dealing with shares of the company's stock. The plan provides that such an optionee may request that the Compensation and Incentives Committee permit the optionee to surrender all or part of an exercisable option in return for stock, cash or a combination of both equal to any appreciation in the value of the surrendered shares over the option price. Compensation expense is recorded to the extent that the market price of the option exceeds the grant price.

In 1981, the Board of Directors adopted amendments to the 1973 Stock Option Plan and a new 1981 Incentive Stock Option Plan, including the availability of an additional 1,000,000 shares under the 1973 plan and 5,000,000 shares under the 1981 plan. This action, which is subject to stockholder approval, is not reflected above.

Performance Award Stock Plan

During 1978, the stockholders approved the Performance Award Stock Plan. Under this plan, 1,500,000 shares were reserved to be awarded to officers and key employees. The Compensation and Incentives Committee will establish the performance standards and determine the formula to evaluate the awards. As of January 27, 1982, no awards have been granted.

(N) Contingent Obligations

On January 29, 1982, Astra, S.A. ("Astra"), the company's Mexican retail affiliate, made a public offering of long-term debt in the principal amount of \$100.0 million to finance the acquisition of land and the construction and fixturing of seven new Astra discount department and food stores in Mexico. The 16¾% notes due 1992 are unconditionally guaranteed by Kmart Corporation. The company has additionally guaranteed a bank loan of \$12.0 million due November 1982.

The company and G. J. Coles & Coy. Limited ("Coles") have guaranteed indebtedness related to certain properties in Australia on a joint and several basis. Coles subsequently indemnified Kmart Corporation from any liability incurred pursuant to these guarantees. As of January 27, 1982, the amount guaranteed was \$51.5 million. [See Note (D) for further information on Coles.]

(O) Quarterly Financial Information (Unaudited)

Each of the quarters includes 13 weeks.

Consolidated Statements of Income (Unaudited)

(Millions)	Quarter			
	First	Second	Third	Fourth
1981				
Sales	\$3,332.1	\$4,027.5	\$4,016.2	\$5,151.2
Licensee fees and other income	37.3	46.4	40.8	71.5
Gross revenue	3,369.4	4,073.9	4,057.0	5,222.7
Cost of merchandise sold	2,403.8	2,978.0	3,010.1	3,968.4
Selling, general and administrative expenses	861.9	956.2	958.3	1,033.3
Interest—net				
Debt	9.2	9.1	27.1	24.0
Capital leases	37.7	39.1	40.6	43.3
Income before estimated income taxes	56.8	91.5	20.9	153.7
Estimated income taxes	23.5	36.3	7.8	39.6
Income from retail operations	33.3	55.2	13.1	114.1
Equity in income of insurance operations	1.3	1.6	.9	.8
Net income	\$ 34.6	\$ 56.8	\$ 14.0	\$ 114.9
Earnings per common and common equivalent share	\$.28	\$.45	\$.12	\$.90

	Quarter			
	First	Second	Third	Fourth
1980				
Sales	\$2,983.5	\$3,470.8	\$3,367.4	\$4,382.7
Licensee fees and other income	31.9	43.3	41.5	58.9
Gross revenue	3,015.4	3,514.1	3,408.9	4,441.6
Cost of merchandise sold	2,154.7	2,540.6	2,460.6	3,261.2
Selling, general and administrative expenses	752.7	825.2	843.2	905.0
Interest—net				
Debt	10.6	14.0	21.7	19.1
Capital leases	31.8	32.5	33.3	37.3
Income before estimated income taxes	65.6	101.8	50.1	219.0
Estimated income taxes	27.6	44.0	20.4	88.8
Income from retail operations	38.0	57.8	29.7	130.2
Equity in income of insurance operations	1.6	1.4	.9	.9
Net income	\$ 39.6	\$ 59.2	\$ 30.6	\$ 131.1
Earnings per common and common equivalent share	\$.32	\$.47	\$.25	\$1.03

Cost of merchandise sold was calculated during each interim period utilizing estimated gross profit rates, including an estimate of inflation in the prices of merchandise purchased during the year. If the results of the physical inventory and the annual rate of inflation determined by using the Bureau of Labor Statistics Department Store Index had been known on a quarterly basis, income before estimated income taxes would have been increased (decreased) as shown:

(Millions)	1981	1980
Quarter		
First	\$(12.6)	\$ 6.8
Second	(20.1)	7.1
Third	2.7	19.1
Fourth	30.0	(33.0)

Directors

A. H. Aymond^{1 2 4}

*Retired Chairman of the Board of
Consumers Power Company*

Arnold H. Bachner

*Chairman of the Board and
Chief Executive Officer of
Kmart Apparel Corp.*

William H. Baldwin^{1 2 5}

*Chairman and Trustee of
The Kresge Foundation*

Robert E. Brewer²

Executive Vice President

Dale R. Corson^{3 6}

*President Emeritus of
Cornell University*

Harry B. Cunningham^{1 2 4 5}

Honorary Chairman of the Board

Robert E. Dewar^{1 2 6}

*Chairman of the Executive
and Finance Committees*

Bernard M. Fauber^{1 2 6}

Chairman of the Board

Carl A. Gerstacker^{1 2 4 5}

*Retired Chairman of the Board
of The Dow Chemical Company*

Martha W. Griffiths^{3 6}

*Partner, Law Firm of
Griffiths & Griffiths*

Russell A. Hansen

Executive Vice President

David B. Harper^{3 6}

*President of Gateway National
Bank of St. Louis*

Samuel G. Leftwich^{1 2 6}

President

J. Edward Lundy^{2 3 4}

*Retired Executive Vice President
of Ford Motor Company*

Paul W. McCracken^{2 5 6}

*Edmund Ezra Day University Professor
of Business Administration,
Graduate School of Business Administration,
University of Michigan*

Grant W. Morck

Executive Vice President

Robert W. Purcell^{2 4 5}

*Retired Business Consultant to
Rockefeller Family & Associates*

1 Member of Executive Committee

2 Member of Finance Committee

3 Member of Audit Committee

4 Member of Compensation and Incentives Committee

5 Member of Nominating Committee

6 Member of Public Issues Committee

Officers

Bernard M. Fauber
*Chairman of the Board
and Chief Executive Officer*

Samuel G. Leftwich
*President and
Chief Operating Officer*

Robert E. Dewar
*Chairman of the Executive
and Finance Committees*

Robert E. Brewer
*Executive Vice President
Finance*

Richard H. Falck
*Executive Vice President
Merchandising*

Russell A. Hansen
*Executive Vice President
Subsidiaries*

Grant W. Morck
*Executive Vice President
Store Management*

Harold E. Wilcox
*Senior Vice President
Personnel and Management Development*

Edward C. Andrews
*Vice President
Southern Region*

Roger E. Davis
*Vice President
General Counsel and Secretary*

Gerald R. Fletcher
*Vice President
Corporate Information Systems*

John P. Johnson
*Vice President
Real Estate*

Helen C. Lefler
*Vice President
and Treasurer*

Norman G. Milley
*Vice President
Sales and General Merchandise Manager*

Larry M. Parkin
*Vice President
Western Region*

Arthur E. Riley
*Vice President
Eastern Region*

Harold O. Scarlett
*Vice President
Construction*

Frederick M. Stevens
*Vice President
Corporate Facilities*

A. Robert Stevenson
*Vice President
Government and Public Relations*

Bernard E. Thomas
*Vice President
Midwestern Region*

Joseph R. Thomas
*Vice President
Distribution, Transportation and
Merchandise Systems*

David P. Walling
*Vice President
Corporate Accounting and Reporting*

Richard O. Williams
*Vice President
Central Region*

Corporate Data

Executive Offices

Kmart Corporation
3100 West Big Beaver Road
Troy, Michigan 48084
Telephone (313) 643-1000

Subsidiaries

Furr's Cafeterias, Inc.
Lubbock, Texas

Kmart Canada Limited
Brampton, Ontario, Canada

Kmart Apparel Corp.
North Bergen, New Jersey

Kmart Insurance Services, Inc.
Dallas, Texas

Annual Meeting

The Annual Meeting will be held
Tuesday, May 25, 1982, at 9:00 a.m.
Detroit time, at Kmart International
Headquarters,
3100 West Big Beaver Road
Troy, Michigan

Transfer Agents and Registrars

National Bank of Detroit
Detroit, Michigan

First Interstate Bank of California
Los Angeles, California

Form 10-K

A copy of the company's
Form 10-K annual report for 1981
to the Securities and Exchange
Commission will be furnished
without charge to any shareholder
upon written request to:

Mr. David P. Walling
Vice President
Kmart Corporation
3100 West Big Beaver Road
Troy, Michigan 48084

K mart Corporation 3100 West Big Beaver Road Troy, Michigan 48084